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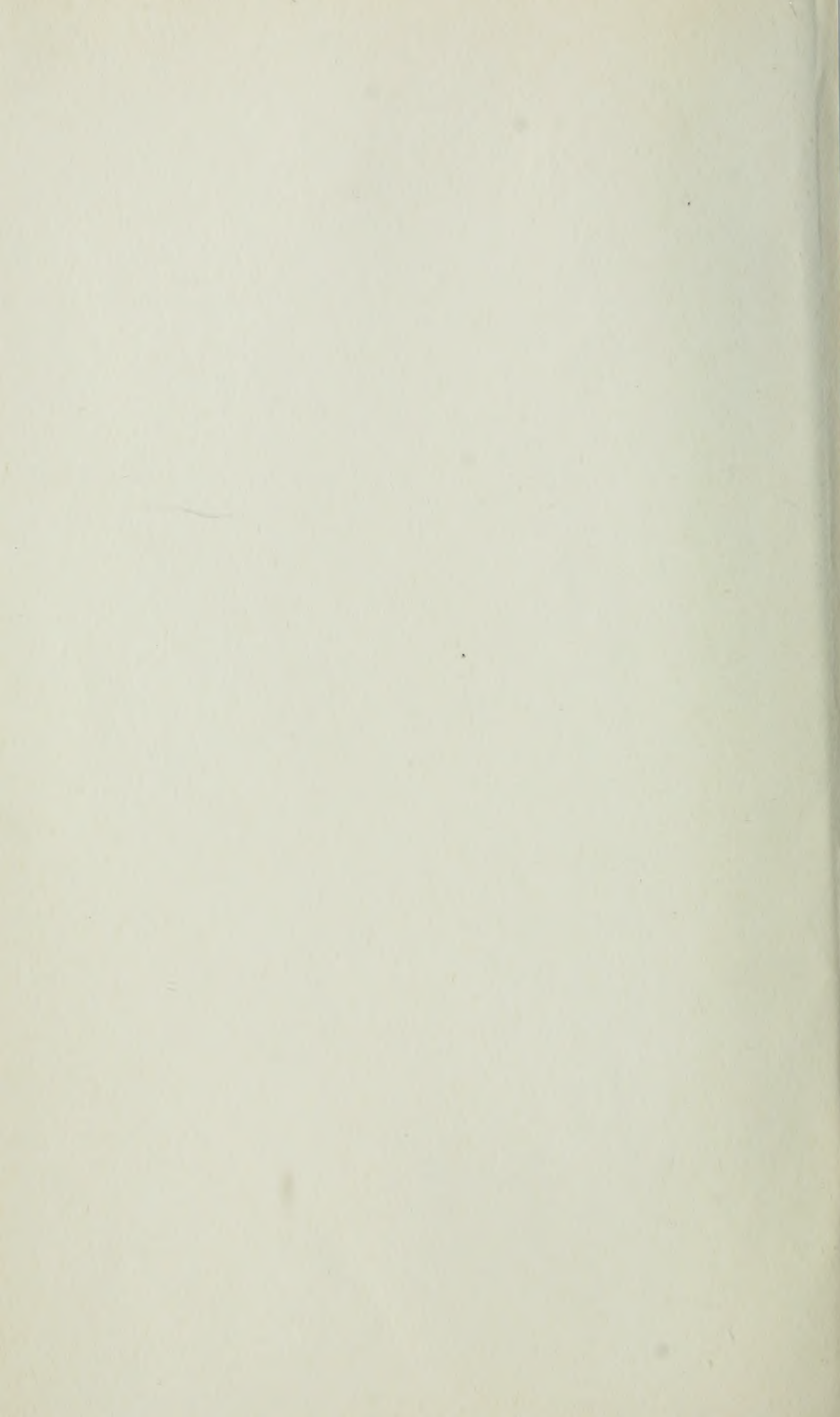
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13d.
No. 11506 2627

United States
Circuit Court of Appeals
For the Ninth Circuit.

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

In Three Volumes

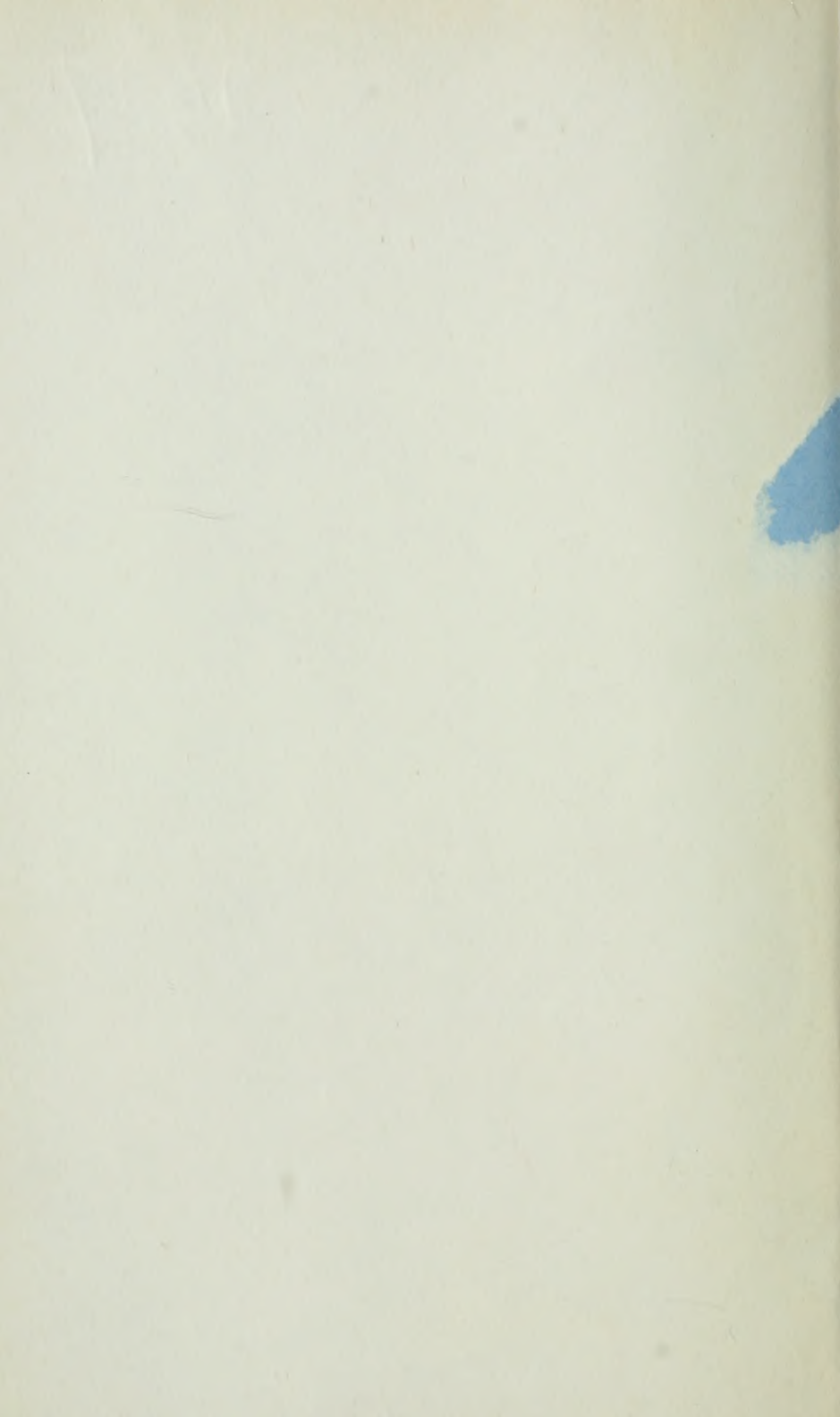
Volume I

Pages 1 to 396

Upon Petitions to Review a Decision of the Tax Court
of the United States

FILED

MAR 27 1947



No. 11506

United States
Circuit Court of Appeals
For the Ninth Circuit.

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

In Three Volumes

VOLUME I

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of the United States

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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APPEARANCES

For Taxpayer:

A. CALDER MACKAY,
ARTHUR McGREGOR,
HOWARD W. REYNOLDS,
ADAM Y. BENNION,
HUGH G. ARNOLD.

For Commissioner:

B. H. NEBLETT,
H. A. MELVILLE.

Docket No. 2257

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

Transferred to Judge Harlan 3/4/46.

1943

Jun. 26—Petition received and filed. Taxpayer notified. Fee paid.

Jun. 26—Copy of petition served on General Counsel.

Jul. 29—Answer filed by General Counsel.

Jul. 29—Request for hearing in Los Angeles, California, filed by General Counsel.

Jul. 31—Notice issued placing proceeding on Los Angeles, Calif., calendar. Service of answer and request made.

1944

Oct. 14—Hearing set Nov. 27, 1944, Los Angeles, Calif.

Nov. 30—Hearing had before Judge Arnold. Motion of respondent for continuance granted.

Continued to next Los Angeles calendar.
Motion for continuance and subpoena
filed at hearing.

1945

Aug. 14—Hearing set October 1, 1945, Los Angeles,
California.

Oct. 8-13-16 and 19—Hearing had before Judge
Mellott on merits. Stipulation of facts
and Stipulation to consolidate cases for
hearing filed. Amendments to answer in
both dockets lodged. Petitioner's brief
due 75 days. Respondent's brief due 60
days. Reply due 30 days.

Nov. 13—Transcript of hearing 10/8/45 filed.

Nov. 13—Transcript of hearing 10/9/45 filed.

Nov. 13—Transcript of hearing 10/10/45 filed.

Nov. 13—Transcript of hearing 10/11/45 filed.

Nov. 13—Transcript of hearing 10/12/45 filed.

Nov. 13—Transcript of hearing 10/13/45 filed.

Nov. 13—Transcript of hearing 10/16/45 filed.

Nov. 13—Transcript of hearing 10/19/45 filed.

Dec. 10—Notice of the appearance of Hugh G.
Arnold as counsel filed.

Dec. 24—Motion for extension to Jan. 17, 1946, to
file brief filed by taxpayer. 1/2/46
granted.

1946

Jan. 17—Brief filed by taxpayer. 1/17/46 copy served.

Mar. 12—Motion for extension to April 12, 1946, to file brief filed by General Counsel. 3/13/46 granted.

Apr. 2—Reply brief filed by General Counsel. Served 4/3/46.

May 9—Motion for leave to file the attached reply brief filed by taxpayer. 5/27/46 granted.

May 27—Reply brief filed by taxpayer. 5/29/46 served. [1*]

Jul. 22—Memorandum Findings of Fact and Opinion rendered, Judge Harlan. Decision will be entered under Rule 50. Copy served 7/23/46.

Aug. 19—Motion for review of report by the Full Court and Memo in support thereof filed by taxpayer.

Aug. 19—Motion for reconsideration filed by taxpayer. 8/20/46 denied.

Aug. 19—Motion for rehearing filed by taxpayer. 8/20/46 denied.

Aug. 19—Motion for leave to file brief as amici curiae, brief lodged, filed by Arthur H. Deibert, et al. 8/20/46 granted.

Aug. 21—Order, that the taxpayer's motion filed 8/19/46 asking for review by the Full Court is denied, entered.

* Page numbering appearing at top of page of original certified Transcript of Record.

1946

Oct. 18—Respondent's computation for entry of decision filed.

Oct. 21—Hearing set 12/4/46 on respondent's motion under Rule 50.

Oct. 31—Consent to settlement filed.

Nov. 12—Decision entered, Judge Arnold, Div. 12.

Nov. 18—Petition for review by U. S. Circuit Court of Appeals for the Ninth Circuit with assignments of error filed by taxpayer.

Nov. 18—Proof of Service filed.

Dec. 5—Designation of contents of record with proof of service thereon filed by taxpayer.

Dec. 5—Motion for order directing transmission of exhibits in original form filed.

Dec. 9—Order, re transmission of documents in original form in lieu of reproduction of copies in the certified record on review, entered. [2]

The Tax Court of The United States
Docket No. 2257

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency determined by the respondent in his deficiency letter dated May 5, 1943, bearing symbols LA:GT:90D:NAB, and as a basis for this proceeding alleges as follows:

I.

Petitioner is and at all times has been a resident of the City of San Clemente, State of California, and as such filed her gift tax returns with the Collector of Internal Revenue for the Sixth District of California.

II.

The notice of deficiency, copy of which is attached hereto and marked "Exhibit A" and made a part hereof, was mailed to petitioner on May 5, 1943.

III.

The taxes in controversy are gift taxes for the calendar year 1941 in the amount of \$7845.75.

IV.

The determination of the taxes set forth in said notice of deficiency is based upon the following errors:

(a) Respondent erred in determining a deficiency in the sum [3] of \$7845.75.

(b) Respondent erred in increasing the total net gifts made by petitioner during the year 1941 by the sum of \$70,000.00.

(c) The respondent erred in determining that the stock of the Carson Estate Company, which was the subject of the gift, had a value of \$600.00 per share and in failing to determine that the fair market value of said stock did not exceed \$175.00 per share.

V.

The facts upon which petitioner relies as a basis for this proceeding are as follows:

(1) Petitioner is and at all times has been a resident of the City of San Clemente, State of California, and as such filed her gift tax returns with the Collector of Internal Revenue for the Sixth District of California.

(2)(a) On June 5, 1941, petitioner transferred and conveyed by gift the following property to the following named individuals:

Property	Donee
100 Shares Carson Estate Company stock	Lucy Cotton
100 Shares Carson Estate Company stock	Victoria Cotton Ogden

(b) On May 31, 1941, petitioner transferred and conveyed by gift the following property to the following named individuals:

Property	Donee
Credit on notes receivable due donor— \$10,500.00	Lucy Cotton
Credit on notes receivable due donor— \$10,500.00	Victoria Cotton Ogden

(c) Petitioner had prior to the year 1941 used \$20,000.00 of the specific exemption allowed by the statute then in force. [4]

(3) In petitioner's gift tax return for the year 1941 she reported as the fair market value of the 200 shares of stock of the Carson Estate Company, the subject of the gift, the sum of \$50,000.00, or a value of \$250.00 per share. The respondent erroneously and illegally increased this value to \$600.00 per share, or a total value of \$120,000.00, which, after allowing exclusions and exemptions as set forth in the deficiency letter, determined as the value of the net gift the sum of \$113,000.00. Petitioner alleges that the fair market value of the said 200 shares of stock of Carson Estate Company on the date of gift, to-wit, June 5, 1941, did not exceed the sum of \$175.00 per share, or a total value of \$35,000.00. Petitioner therefore alleges that she overpaid her gift taxes as shown in her return for the year 1941.

Wherefore, petitioner prays that The Tax Court of the United States hear and determine this appeal

and render its decision in accordance with the foregoing, allowing the refund herein demanded.

Dated June 21, 1943.

/s/ A. CALDER MACKAY,

/s/ ARTHUR McGREGOR,

/s/ HOWARD W. REYNOLDS,

Attorneys for Petitioner. [5]

State of California,
County of Los Angeles—ss.

Victoria L. Cotton, being first duly sworn, deposes and says that she is the petitioner above-named; that she has read the foregoing petition and knows the contents thereof and that the same is true of her own knowledge, except the matters which are therein stated to be upon information and belief and that as to those matters she believes it to be true.

VICTORIA L. COTTON.

Subscribed and sworn to before me this 21st day of June, 1943.

[Seal]

MINNA A. NEWMAN,

Notary Public in and for said
County and State [6]

EXHIBIT A

Treasury Department
Internal Revenue Service
417 South Hill Street
Los Angeles, California

LA:GT:90D:NAB

May 5, 1943

Mrs. Victoria L. Cotton,
621 South Spring Street, Room 400,
Los Angeles, California.

Madam:

You are advised that the determination of your gift tax liability for the taxable year ended December 31, 1941, discloses a deficiency of \$7,845.75 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D.C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the International Revenue Agent in Charge,

Los Angeles, California, for the attention of LA: Conf:90D. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner,

By /s/ GEORGE D. MARTIN,
Internal Revenue Agent in
Charge.

Enclosures:

Statement.

Form of waiver.

NAB:ft [7]

Statement

Gift tax year	Liability	Assessed	Deficiency
1941	\$9,743.25	\$1,897.50	\$7,845.75

In making this determination of your Federal gift tax liability, careful consideration has been given to the report of examination dated January 6, 1943.

A copy of this letter and statement has been mailed to your representative, Mr. A. Calder Mackay, 523 West Sixth Street, Los Angeles, California, in accordance with the authority contained in the power of attorney executed by you. [8]

Adjustments to Net Gifts

Schedule A of return

	Returned	Determined
Total gifts	\$71,000.00	\$141,000.00
Less: Total exclusions	8,000.00	8,000.00
Total included amount of gifts.....	\$63,000.00	\$133,000.00
Specific exemption	20,000.00	20,000.00
Net gifts, 1941	\$43,000.00	\$113,000.00

Explanation of Adjustments

Schedule A of return

Item 3	\$25,000.00	\$ 60,000.00
Item 4	25,000.00	60,000.00

The determined value at \$600.00 per share for stock of the Carson Estate Company, being the above Items 3 and 4, is predicated upon all relevant factors, such as earnings, dividends, fair market value of the corporate assets, its future prospects, etc. [9]

Computation of Gift Tax

	Returned	Determined
Net gifts for		
1941	\$43,000.00	\$113,000.00
Total net gifts		
for preceding		
years	0.00	0.00
Total net		
gifts	\$43,000.00	\$113,000.00
Tax on total		
net gifts	\$ 1,725.00	\$ 8,857.50
Defense Tax.....	172.50	885.75
Total tax payable for 1941..	\$1,897.50	\$9,743.25
Total tax assessed:		
Feb. 1942 List, Page 201, Line 7.....		1,897.50
Deficiency		\$7,845.75

Received and filed June 26, 1943. [10]

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

I and II. Admits the allegations contained in paragraphs I and II of the petition.

III. Admits that the taxes in controversy are gift taxes for the calendar year 1941; denies the remainder of the allegations contained in paragraph III of the petition.

IV. Denies the allegations of error contained in paragraph IV of the petition.

V. (1) and (2) (a), (b) and (c). Admits the allegations contained in subparagraphs (1) and (2) (a), (b) and (c) of paragraph V of the petition.

(3) Admits that in petitioner's gift tax return for the year 1941 she reported as the fair market value of the 200 shares of stock of the Carson Estate Company, the subject of the gift, the sum of \$50,000.00, or a value of \$250.00 per share; denies the remainder of the allegation contained in subparagraph (3) of paragraph V of the petition.

VI. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHELL, BHN,
Chief Counsel, Bureau of Internal Revenue.

Of counsel:

B. H. NEBLETT,
Acting Division Counsel, Bureau of Internal Revenue.

BHN/mm 7/23/43

Received and filed July 29, 1943. [12]

The Tax Court of The United States
Docket Nos. 2257, 7583

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

VIRGINIA CALDWELL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

A. Calder Mackay, Esq., Arthur McGregor, Esq.,
Howard W. Reynolds, Esq., Adam Y. Bennion, Esq.,
and Hugh G. Arnold, C.P.A., for the petitioners.

H. A. Melville, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT
AND OPINION

Harlan, Judge: This is a proceeding to redetermine gift tax deficiencies found against petitioners for the calendar year 1941 as follows:

Docket No.

2257 Victoria L. Cotton\$ 7,845.75

7583 Virginia Caldwell 18,645.51

Petitioner, Victoria L. Cotton, claims that she overpaid her gift tax for 1941 on the ground that she had paid a gift tax on 200 shares of stock of the Carson Estate Company at a valuation of \$250 per share, whereas the true value of said stock was but \$175 per share.

During the hearing counsel for respondent, by permission of the Court, filed an amended answer in Docket No. 7583, Virginia Caldwell, asking for a determination of an increased deficiency based upon the claim that the fair market value of the stock of the Dominguez Estate Company, formerly determined by the Commissioner to be \$950 per share, should be determined by the Court to be \$1,000 and that the stock in the Francis Land Company, formerly determined by the Commissioner to be of the value of \$1,045 per share, should be determined by the Court to be \$1,100 per share.

The questions to be resolved herein are as follows:

- (1) What was the fair market value of 200 shares of stock of Carson Estate Company on June 5, 1941?

(2) What was the fair market value of 100 shares of the Dominguez Estate Company on August 11, 1941?

(3) What was the fair market value of 105 shares of stock of the Francis Land Company on August 11, 1941?

At the hearing the parties stipulated as follows:

That Docket Nos. 2257 and 7583 should be consolidated for hearing, consideration and opinion;

That the oral and documentary evidence and stipulation in Docket No. 2257 should be deemed to have been received also in Docket No. 7583;

That for the purposes of this proceeding any reference to the date of June 5, 1941, and any valuation as of that date shall be applicable to the date of August 11, 1941; and

That the market value of any assets stipulated or determined by the Court as of June 5, 1941, shall be deemed to be the fair market value as of August 11, 1941; and [14]

That the condensed balance sheets of the three companies and the stockholdings of the three companies introduced in evidence, bearing date of May 31, 1941, shall be considered as of June 5, 1941, prior to the gifts of stock made by the petitioners herein in 1941.

For the purpose of brevity, Dominguez Estate company will be designated as Dominguez, the

Francis Land Company will be designated as Francis and Carson Estate Company will be designated as Carson.

FINDINGS OF FACT

Dominguez, Francis and Carson were three closely owned holding companies. Dominguez had outstanding 10,499 shares of stock. 5,499 shares of this stock was held by Francis and this latter company had 5,000 shares of stock outstanding. Carson owned 1,785 shares of Francis and 1,353 of Dominguez and had outstanding 7,412 shares of stock. Each of these corporations had but one class of stock outstanding and substantially all of the shares not owned by the respective corporations, were owned by relatives of petitioners.

The condensed balance sheet of Dominguez on June 5, 1941, eliminating capital stock liabilities and surplus, is as follows:

Assets	Book Value	Stipulated Fair Market Value
Current Assets	\$ 869,889.84	\$ 869,889.84
Stocks and Bonds.....	2,059,292.29	1,141,269.74
Ranch Real Estate.....	3,741,170.35	1,629,950.00
Other Real Estate	3,133,410.63	1,631,266.69
Oil Properties		4,500,000.00*
<hr/>		
Other Assets	\$9,803,763.11	\$9,772,376.27
<hr/>		
Liabilities		
Current Liabilities	\$ 239,416.50	\$ 292,677.09

*Valuation determined by the Court after hearing in this case.

The condensed balance sheet of Francis on June

5, 1941, eliminating capital stock liabilities and surplus, is as follows:

Assets	Book Value	Stipulated Fair Market Value
Current Assets	\$ 10,919.59	\$ 10,919.59
Stocks and Bonds.....	21,630.00	21,630.00
Other Real Estate.....	50,672.31	50,672.31
Investment in Dominguez Estate Co. 5499 shs. at \$1,019 per share	5,603,865.93	4,949,100.00*
Total Assets	<u>\$5,687,087.83</u>	<u>\$5,032,321.90</u>
Liabilities		
Current Liabilities	\$ 65,241.02	\$ 85,331.34

*Determined by the Court after hearing at \$900 per share.

The condensed balance sheet of Carson on June 5, 1941, eliminating capital stock liabilities and surplus, is as follows:

Assets	Book Value	Stipulated Fair Market Value
Current Assets	\$ 201,936.05	\$ 201,936.05
Stocks and Bonds	12,688.51	None
Ranch Real Estate	885,637.50	446,418.04
Other Real Estate	528,322.04	147,200.00
Oil Properties		285,000.00*
Investments:		
Dominguez—1353 sh. at \$722	977,119.31	1,217,700.00**
Francis—1785 sh. at \$1,137	2,029,045.20	1,767,150.00**
Total Assets	<u>\$4,634,748.61</u>	<u>\$4,065,404.09</u>
Liabilities		
Current Liabilities	\$ 26.00	\$ 34,157.48

*This amount was stipulated at the hearing.

**These amounts were determined by the Court after hearing at \$900 per share for Dominguez and \$990 per share for Francis.

The earned surplus for these three companies for the years 1927 to May 31, 1941,* is as follows:

Year	Dominguez	Francis	Carson
1927	\$ 7,913.89		\$ 13,732.96
1928	(50,714.37)	\$77,427.77	18,750.81
1929	None	36,377.95	67,236.79
1930	275,266.69	29,244.78	72,689.18
1931	87,536.21	43,329.36	20,429.03
1932	52,870.12	11,250.34	48,482.01
1933	368,819.31	6,905.33	33,381.71
1934	(15,810.95)	11,685.33	71,180.16
1935	226,215.97	8,534.14	108,012.81
1936	587,204.59	8,538.04	133,927.02
1937	832,257.15	6,491.88	151,774.45
1938	1,116,176.87	4,658.83	179,554.78
1939	1,049,771.14	4,212.39	206,025.81
1940	790,124.61	2,803.53	231,369.88
1941 (to May 31) ..	749,224.21	15,119.88	253,315.11

*Due to the fact that these companies kept their books on a cash basis, the amount for 1941 is a rough estimate but is not sufficiently incorrect to affect the finding in this case.

Petitioner, Victoria L. Cotton, is a resident of San Clemente, California, and filed her gift tax return for 1941 with the collector of internal revenue for the sixth district of California.

On June 5, 1941, she gave her two daughters, Lucy Cotton and Victoria Cotton Ogden, 100 shares each of Carson stock. She valued these shares at \$250 per share and paid the tax thereon. The Commissioner determined their value to be \$600 per share.

Petitioner Virginia Caldwell is a resident of Los Angeles, California, and filed her gift tax return for 1941 with the collector of internal revenue for

the sixth district of California. On August 11, 1941, she gave to James Caldwell Cooper 25 shares of stock of Dominguez and to Grace Caldwell Cooper 75 shares of stock of Dominguez and 105 shares of Francis. [17] These gifts were reported and gift tax paid on a value of \$340 per share for the Dominguez stock and \$374 per share for the Francis stock.

The shares of these companies are not listed and are not traded or dealt in on any market.

The oil properties listed in Dominguez balance sheet consisted of royalties payable in kind or at current posted prices at the election of Dominguez. This is not an operating company. It has frequently elected to take its royalties in kind from the most valuable well and this oil has been sold at a substantial advance above posted prices. It is estimated that in these oil wells Dominguez will receive before the exhaustion of the wells 7,992,871 barrels of oil which, at the estimated posted prices, will produce a royalty income of \$9,029,979.

At the time of the gifts involved herein and for some years prior thereto there had been considerable curtailment of production in the California oil fields. Practically all of the so-called ranch real estate owned by Dominguez was not income producing but was being held for the purpose of possible development of oil properties.

For the five years prior to 1941 and the first five months of 1941 the dividends per share of Dominguez were as follows:

1936	\$61.50
1937	66.00
1938	74.00
1939	72.00
1940	72.00
1941 (5/12th of \$82).....	34.00

For the five years preceding 1941 and the first five months of 1941 the dividends paid per share by Francis were as follows: [18]

1936	\$66.50
1937	71.50
1938	78.50
1939	77.75
1940	76.25
1941 (5/12th of \$84.50).....	35.20

The total dividends paid by Carson for the five years preceding 1941 and 5/12ths of 1941 were as follows:

1936	\$230,428.00
1937	248,302.00
1938	216,869.21
1939	237,184.00
1940	237,184.00
1941 (5/12th of \$252,008).....	105,003.30

From June 1936 to April 1941 the stockholders of Dominguez made repeated transfers of the stock in said company at a valuation of \$1,000 per share. In 1940 two shares were transferred from one brother to another at a valuation of \$700 per share. In 1939 Victoria L. Cotton transferred to her two daughters 99 shares at \$1,000 per share. In the official report of Dominguez to its stockholders in 1941 it was stated that the appraised value of the stock of Dominguez was \$1,000 per share.

From October 1936 to April 1941 repeated transfers of stock in Francis occurred among the members at a valuation of \$1,100 per share. There were also a few transactions at slightly less than this amount and on January 18, 1939, Victoria L. Cotton sold 35 shares of this stock to her two daughters for a consideration of \$35,000.

From 1935 to 1940 a few sales of the stock of Carson had occurred at \$300 per share.

In 1936 Dominguez set aside a fund of \$500,000 to purchase its own stock from any of its members who desired to sell at a price not to exceed \$1,000 per share, it being the declared purpose of the directors to prevent any of this stock being sold on the open market. [19]

The fair market value of 200 shares of stock of Carson Estate Company on June 5, 1941, was \$100,000. The fair market value of 100 shares of Dominguez Estate Company on August 11, 1941, was \$90,000. The fair market value of 105 shares of stock of Francis Land Company on August 11, 1941, was \$103,950.

Additional stipulations in this record concerning the earnings and the financial operations of these three companies are incorporated herein by reference. Most of these stipulations were referred to by the various experts who testified in the case as constituting factors in their conclusions.

OPINION

This case consumed more than one week in oral hearings and resulted in 765 pages of transcribed

testimony, with numerous exhibits made up of many sheets of complicated and involved figures. Petitioner has submitted two briefs containing 290 printed pages and the respondent has answered with one of 177 pages, all of this being devoted to the analysis of the testimony of 14 experts, six submitted by the petitioner and eight by the respondent. The basic purpose of all of this outlay of effort is to establish what would have been the fair market value of the stock involved if on the basic date there had been a willing seller who would have consummated a sale with a willing buyer and neither of them being under compulsion. Needless to say, neither of these imaginary individuals has ever existed. There have been no real sales of any of this stock involving other than families of the stockholders and it has been the declared purpose of the managers of the basic company, Dominguez, that none of this stock should be sold on the open market. [20]

In this case, if it were not for the fact that the Commissioner has abandoned his original determination of value of the Dominguez stock and asked for an increased valuation, by which act he has cast some doubt upon the presumption of correctness of his determination; and also if it were not for the fact that the expert testimony produced by the Commissioner at the hearing failed in some respects to support the Commissioner's finding, we would be very much inclined in a case involving so many speculative and argumentative factors to accept the Commissioner's finding as our own and

rely on the presumption that it is correct.

The speculative factors to which we refer involve the effect of the prospect of increased taxation on the price of stock; the effect of falling interest rates generally; of the World War which some people contemplated as being inevitable in the spring of 1941; of the possibility of future price controls on the one hand and almost unlimited Government purchases on the other; of stock market fluctuations in 1941 (concerning the nature of which there is considerable dispute); of the probability of the lifting of control on production of oil wells generally; of the weight to be given in considering the price of this stock to the possession by the corporations involved of ranch land producing no present income but being held for oil well development; and of the relative merits of various methods of appraising oil well property. These were among the most frequently mentioned factors which the experts testified that they took into consideration in evaluating this stock along with the tangible assets, the past earning records and future earning prospects of these different companies.

One of petitioners' experts in speaking of these various factors and methods of appraisal said:

I used the method of making all these appraisals, wrapping them up and looking them over and weighing them and arriving at my estimate. Market value must be an estimate. It can't be a precise meticulous mathematically derived figure. It has to be an estimate. It

is based on the conception of a transaction which did not take place between two persons who do not exist.

Counsel for petitioners in their brief say of the involved character of a determination of value under conditions such as exist in the present case:

* * * This is a type of judgment which a lawyer or a judge cannot be expected to have with respect to all types of property any more, for example, than a man skilled in real estate in one part of the county would be able to express a competent opinion as to the value of land in another section of the country where local conditions are unknown to him.

It is in this last respect that the opinions of expert witnesses become material, for through them the court is able to bring sound judgment to bear upon specific facts.

With this in mind we have analyzed the evidence as to the value of this stock under the following heads: Petitioners' witnesses, respondent's witnesses, interfamily sales, and appraised value by companies and officers.

Petitioners' Witnesses

Witnesses:	Oil Royalties		Shares of Stock at Issue Francis	Carson
	Owned by Dominguez	Dominguez		
Wents	\$2,701,361.00			
Paine	3,000,000.00	\$420.00	\$420.00	\$214.00
Lovelace		418.00	367.00	192.00
McFie		304.00	334.40	240.80
McCuen		380.00	375.80	230.00
Eitner	4,988,600.00	407.00	425.50	

Respondent's Witnesses

Witnesses:	Oil Royalties		Shares of Stock at Issue Francis	Carson
	Owned by Dominguez	Dominguez		
Evans	\$4,000,000.00			
Webb—(100 times monthly earnings — approximate computation	5,335,000.00			
Pemberton	4,000,000.00			
Clute	4,450,000.00			
Corey	4,330,255.00			
Phillips	4,934,391.00	759.00	834.74	444.82
Gally		861.46	947.60	518.13
Grimes	4,819,070.00	933.31	1,026.64	558.78

Interfamily Sales

Dominguez	\$700 to \$1,000
Francis	\$1,000 to \$1,100
Carson	\$300.00

Intercompany Ratings

Dominguez—Board of Directors	\$1,000.00	
Francis—Book Value	1,019.00	
Carson—Book Value	722.00	\$1,137.00

After reviewing this record, examining exhibits, studying the briefs, the asset value of the stock of the respective corporations, their past earnings, the prospects of future earnings, and all speculative and other factors affecting the price of these stocks on the dates of the gifts, it is our conclusion that their fair market value on these dates was as follows:

Dominguez Estate Company Stock.....	\$900 per share
Francis Land Company Stock.....	990 “ “
Carson Estate Company Stock.....	500 “ “

Judgment will be entered under Rule 50.

Entered July 22, 1946.

[Seal] [23]

The Tax Court of The United States

Docket No. 2257

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 7583

VIRGINIA CALDWELL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

MOTION FOR REHEARING

Come now the petitioners above-named, by and through their counsel, and move that the report entered herein on July 22, 1946, be set aside and vacated and that the proceedings be placed upon the calendar for rehearing at Los Angeles, California.

The grounds and reasons in support of this motion are as follows:

(1) Petitioners have not been accorded a fair hearing in that

(a) The Judge who heard the evidence (Judge Mellott) took no part in deciding the case.

(b) The credibility of fourteen expert witnesses (six called by petitioners and eight by the respondent) depended upon their respective appearances and personal demeanors upon the witness stand and could not be properly appraised by simply reading the record. [24]

(c) Findings of fact were made and consideration in the opinion was given to evidence which was stated to be hearsay and mere speculation by the Judge who heard the evidence. (T. 499.)

(d) The report, on page 8, apparently abandons the definition of fair market value that was expressed by the Judge who heard the evidence and upon which petitioners were led to believe the case would be decided. (T. 603.)

(e) Findings of fact were made and consideration in the opinion was given to certain alleged intra-family sales of stock and the values at which gifts of stock were reported for gift tax purposes, as far as five years removed from the basic date. It was respondent's burden to prove that said transactions were representative sales, which he made no effort to sustain. The evidence was taken subject to petitioners' objection that it was irrelevant and incompetent as not reflecting arms-length transactions and as being too remote in point of time. If credence is to be given to this evidence the full facts surrounding the transactions should be presented and it is respondent's burden to do so.

Wherefore it is respectfully prayed that this motion be granted.

/s/ A. CALDER MACKAY,
/s/ ARTHUR McGREGOR,
/s/ HOWARD W. REYNOLDS,
/s/ ADAM Y. BENNION,
Counsel for Petitioners.

/s/ HUGH G. ARNOLD,
Of Counsel.

Filed Aug. 19, 1946.

Denied Aug. 20, 1946.

/s/ BYRON H. HARLAN,
Judge. [25]

[Title of Tax Court and Causes.]

MOTION FOR RECONSIDERATION

Come now the petitioners above named, by and through their attorneys, and move, in the event the motion for rehearing filed concurrently herewith should be denied, that the report entered herein on July 22, 1946, be set aside and vacated and the proceedings be reconsidered upon the grounds and for the reasons set forth hereinbelow.

As grounds for this motion petitioners allege as follows:

I.

The Court erred as a matter of law in finding and deciding that Dominguez Estate Company was a holding company.

II.

The Court erred as a matter of law in finding and deciding that Dominguez Estate Company was "not an operating company." [26]

The record is replete with evidence showing that the Dominguez Estate Company was not a holding company but was in fact an operating company. The stipulation and exhibits show that this company was purchasing, selling, developing and operating its real properties. Its rentals from buildings owned and operated amounted to in excess of \$180,000.00 for each of the four years immediately preceding the year 1941, while its expenses of operating such buildings for the same period were in excess of \$125,000.00 per year; and for the five months' operations in 1941 its rental income amounted to \$80,429.72 and its expenses amounted to \$37,836.70. Its income from building operations for the period from 1927 to June 5, 1941, amounted to \$1,071,896.72 and its rental expenses amounted to \$700,927.02. General and administrative expenses, in addition to those stated above, exceeded \$100,000.00 in each of the four years preceding 1941. Its ranch income from 1927 through June 5, 1941, amounted to in excess of \$400,000.00; its activities in the pur-

chasing and selling of securities and in taking oil in kind and handling and disposing of it also negative the idea that it was not an operating company. (Stip. and Ex. 4-D.)

III.

The Court erred as a matter of law in finding and deciding that the fair market value of the oil properties of Dominguez Estate Company was \$4,500,000.00 for the following reasons:

(A) There is no competent evidence to support this value.

(1) All the witnesses except Mr. Grimes and Mr. Phillips testified to a value lower than \$4,500,000.00.

(a) Mr. Grimes admittedly was not qualified as a petroleum engineer. (T. 633.)

(b) Mr. Grimes has "had very slight experience with oil [27] properties." (T. 633.)

(c) Mr. Grimes testimony with respect to the oil properties is based solely on a comparison of stock market ratios for 1940 and he admittedly had no "familiarity" with stock market conditions at the basic date, to-wit, June 5, 1941. (T. 639.)

(d) Mr. Grimes' opinion took into account the earnings from oil only in 1940 and ignored the estimated future income as stipulated by the parties. (T. 611-13.)

(e) Mr. Phillips was not familiar with the evi-

dence, having based his opinion only on Exhibit 11-K-2. (T. 548-9.)

(f) Mr. Phillips admittedly was not an oil engineer and claimed no experience in valuing oil properties. (T. 572.)

(g) Mr. Phillips' testimony as to the value was based upon a misconception of a "formula" he stated he had seen used by engineer Paine. (T. 545.)

(B) The Court erred in assuming that Mr. Eitner testified that the fair market value of the oil properties of Dominguez Estate Company was \$4,988,600.00.

(1) Mr. Eitner admittedly had "no experience" in connection with valuing of oil properties. (T. 333.) The value of the oil properties of Dominguez Estate Company of \$4,988,600.00 ascribed in the opinion to Mr. Eitner was not fair market value but merely "present worth," which was used only to make a comparison of reflected stock values in a transaction handled by Mr. Eitner's firm in 1938. This transaction involved the Dominguez Oil Fields Company. Mr. Paine had made a "present worth" determination of \$66.00 per share for the stock of this company. Mr. Eitner's firm, Blythe & Company, had purchased the stock of Dominguez Oil Fields Company for \$32.50 per share, [28] or 50% of the "present worth." (T. 341.)

(C) The Court in determining the value of the oil royalties of Dominguez Estate Company erred in failing to give proper consideration to the income

tax burden on the estimated future income of the oil properties. The Tax Court and its predecessor, the Board of Tax Appeals, as well as the Courts, have universally recognized that in valuing oil properties, and particularly in valuing the estimated future probable income therefrom, consideration must be given to the estimated future taxes which would reduce the amount of return to an investor.

(1) Mr. Grimes, government witness, was asked the following question and gave the following answer:

“Q. * * * It is a fact, Mr. Grimes, that the higher the taxes, particularly the higher the taxes on future income, the less the value would be, isn't that a fact?

A. Why, yes. I think that is self-evident.”

(2) Mr. Grimes was also shown a copy of his book on valuation and was asked the following questions and gave the following answers:

“Q. On page 99 I want to call your attention to just one item here: ‘The imposition of an income tax serves not only to reduce the amount of future income which the investor retains from the yield of the income producing property, but also to reduce the net earnings of sinking funds set aside to cover the return of the initial investments.’ You are still of that same opinion, aren't you?

A. Yes.

Q. And I will read you also another one here, where you said that: 'But when depreciation or other deductions in the nature of a capital return operate to reduce the income subject to tax, and the price which an investor is willing to pay for a property is considered as determined on the choice of a future net yield after the payment of the tax on income and proper provision for the return of capital, the problem is much more complex, as the value sought depends upon the amount of future tax.' You still maintain that same view as expressed in that?

A. Yes, I do." [29]

(3) An excerpt from Moody's of May 5, 1941, Volume 33, No. 18, reads as follows:

"Sagging prices without any heavy liquidation were seen in last week's stock market. Many stocks touched new lows. No startling news accompanied this market reaction, which seems to be due partly to war conditions involving visions of higher taxes. It has been almost universally expected that the normal taxes of corporations would be increased from 24 per cent to 30 per cent; in fact, many corporations included the rate of 30 per cent in their reports for the first quarter. It was proposed that this increase could be accomplished by imposing a surtax of six per cent on top of the normal tax of 24 per cent." (T. 647.)

(4) See also G.C.M. 45 C.B. V-1, 65.

(D) The Court erred as a matter of law in giving any credence to the testimony of respondent's witness Evans in that:

(1) Mr. Evans was not familiar with the terms of the Reyes lease, although he admitted that it would have a bearing on valuation. (T. 396.)

(2) Mr. Evans did not give any consideration or effect to the income tax burden on the estimated future income of the oil properties. (T. 399-401.)

(E) The Court erred as a matter of law in giving any credence to the testimony of respondent's witness Webb in that:

(1) Mr. Webb was not a qualified engineer and claimed no such qualification. (T. 405.)

(2) Mr. Webb was not familiar with the Reyes lease. (T. 417.)

(3) Mr. Webb was not familiar with the record, having been given for consideration only Exhibit 11-K-2: (T. 406.)

(4) Mr. Webb did not give consideration or effect to the income tax burden on the estimated future income of the oil properties. (T. 418.)

(5) Mr. Webb admitted to Judge Mellott that his method of 100 times monthly pay-out "is a very erroneous way to figure values." (T. 418.) [30]

(6) Mr. Webb expressed no opinion of value in dollars and cents. (T. 416, 420.)

(F) The Court erred as a matter of law in

giving any credence to the testimony of respondent's witness Mr. Pemberton in that:

(1) Mr. Pemberton was not familiar with the oil properties. (T. 429.)

(2) Mr. Pemberton was not familiar with the evidence, having been shown only Exhibit 11-K-2. (T. 428.)

(3) Mr. Pemberton did not give consideration or effect to the income tax burden on the estimated future income of the properties. (T. 432.)

(G) The Court erred as a matter of law in giving any credence to the testimony of respondent's witness Clute in that:

(1) Mr. Clute was not familiar with the properties to be valued.

(2) Mr. Clute did not give consideration or effect to the income tax burden on the estimated future income of the oil properties. (T. 464.)

(3) Mr. Clute's valuation was merely a mathematical formulized computation. (T. 444.)

(H) The Court erred as a matter of law in giving any credence to the testimony of respondent's witness Mr. Corby in that:

(1) Mr. Corby was not familiar with the properties. (T. 481.)

(2) Mr. Corby was not familiar with the evidence, having knowledge of only Exhibit 11-K-2. (T. 475.)

(3) Mr. Corby did not give consideration or effect to the income tax burden on the estimated future income of the oil properties. [31]

(4) Mr. Corby's testimony with respect to the pay-out is contrary to the testimony of all the other witnesses. (T. 472.)

(I) The Court erred as a matter of law in giving any credence to the testimony of respondent's witness Phillips in that:

(1) Mr. Phillips was not a qualified engineer and claimed no such qualification. In fact, he stated that he was "not equipped to pass upon the fair market value of oil properties." (T. 546.)

(2) Mr. Phillips was not familiar with the properties of the Dominguez Estate Company.

(3) Mr. Phillips was not familiar with the evidence, having been shown only Exhibit 11-K-2. (T. 548-9.)

(4) Mr. Phillips did not give consideration or effect to the income tax burden on the estimated future income of the oil properties.

(5) Mr. Phillips' testimony was based purely upon an erroneous misconception of a formula which did not exist. (T. 686.)

(6) Mr. Phillips, although not qualified to determine the value of oil properties, erroneously attempted to reflect the value thereof in the stock.

While discounting the stipulated fair market value of the other assets of Dominguez Estate Company by 25%, he allowed no such discount to the value, arrived at by erroneous formula, of the oil properties.

(J) The Court erred as a matter of law in giving any credence to the testimony of respondent's witness Mr. Grimes in that:

(1) Mr. Grimes admitted that he was not an oil engineer and had had very slight experience with oil properties. (T. 633.)

(2) Mr. Grimes, in arriving at his value, did not give consideration or effect to the income tax burden on the estimated future income of the oil properties, although he admitted that the higher the taxes on future [32] income the less the value would be. (T. 642.)

(3) Mr. Grimes, in arriving at his value of the royalties of Dominguez Estate Company, erroneously used the earnings for 1940 of several companies. The value of oil properties in California can hardly be determined by the New York stock market, with which Mr. Grimes was unfamiliar.

(4) Mr. Grimes, in arriving at his value of the stock of Dominguez Estate Company, did not even claim familiarity with the stock market conditions on June 5, 1941. In fact, he disclaimed familiarity. (T. 639.)

(5) Mr. Grimes failed to take into consideration the increase in taxes that was threatened during the

spring of 1941 and that was imminent on the basic date, to-wit, June 5, 1941. (T. 647.)

(6) Mr. Grimes, in arriving at a fictitious reflected value for the oil properties of Dominguez Estate Company, added such erroneous value to the balance sheet without making any discount whatsoever, and merely divided the total value of the assets by the number of shares, a method of valuation which has been consistently repudiated by the Tax Court and its predecessor, the Board of Tax Appeals. (T. 674.)

(7) Mr. Grimes erroneously failed to take into consideration the fact that the minority stockholder has no right to force liquidation and he based his value of the stock upon the liquidating value. He admitted that his opinion as to the fair market value would not be the same to an outsider "who was in no manner connected with the family." He stated that under such circumstances he could not base a value on the asset value.

(8) Mr. Grimes' value is based entirely upon a mathematical computation, having no relation whatsoever to the elements which the Tax Court [33] and its predecessor, the Board of Tax Appeals, have considered necessary in determining fair market value, nor to the elements required by the Commissioner's Regulations to be considered.

IV.

The Court erred as a matter of law in determining that the oil royalties of Dominguez Estate Com-

pany had a value at the basic date, June 5, 1941, of \$4,500,000.00 in that there is no evidence in the record to sustain such value. The highest value for the oil properties of Dominguez Estate Company that was given by any witness was \$4,450,000.00, and that was by Mr. Clute, whose testimony is entirely unreliable from a legal standpoint.

V.

The Court erred as a matter of law in failing to find and decide that the oil properties of the Dominguez Estate Company on June 5, 1941, had a value not in excess of \$3,000,000.00.

VI.

The Court erred in failing to give credence to the testimony of Messrs. Wents and Paine.

(A) Each of these witnesses was qualified in every respect, and as to Mr. Paine, admitted to be qualified by respondent's own witnesses. He used the method in determining the value of the oil properties that has been generally accepted in the United States and particularly in the State of California.

(1) Mr. Phillips admitted that his firm had great confidence in Mr. Paine's ability and had used him on many occasions. (T. 545.)

(2) Mr. Pemberton in his testimony verified the method adopted by Messrs. Paine and Wents. (T. 431.) The method, admittedly correct by Mr. Pemberton, proved conclusively that Mr. Pemberton's value arrived at by [34] the application of this

particular method would have been approximately \$3,000,000.00, the same as the value given by Mr. Paine, if Mr. Pemberton had considered all the facts of record, and particularly the \$1.13 price per barrel of oil for Dominguez oil.

(3) The method was proved to be correct by a comparison with the two most comparable transactions in Southern California in recent years, namely, the Grubb Estate sale and the sales of Dominguez Oil Fields Company stock, both of which took place in 1938.

(a) Mr. Pemberton testified on direct examination that he used the same method of figuring here as he had in the Grubb Estate sale. (T. 424.) He admitted on cross-examination that the current revenue derived from the Grubb Estate oil was \$1.57 per barrel; and that the sales price of the royalty reflected a value of oil in the ground of 61c per barrel, or approximately 38% of the price the oil was bringing at the surface. (T. 425-6.)

(b) On a comparable method, since the Dominguez oil is stipulated to have been \$1.13 oil at the surface, the oil in the ground should be valued at 43.2c per barrel, or 38% of \$1.13. Mr. Paine correctly testified, without contradiction, that this ratio of 38% between the value of oil in the ground and the price it brings at the surface is a fixed, constant ratio, because as the price at the surface varies the value of the oil in the ground will vary accordingly. (T. 694.)

(c) Mr. Paine's value of \$3,000,000.00 reflected a value of 40c per barrel in the ground. (T. 159.) This was also admitted by Mr. Grimes. (T. 668.)

(d) Mr. Pemberton, although admitting that the method was a sound one, could not and did not make this comparison, for he did not even know that the Dominguez oil was \$1.13 per barrel oil. He knew nothing about [35] the barrels. (T. 428.)

(e) Mr. Paine's method of substantially discounting present worth is also supported by the testimony of Mr. Pemberton, as well as by cross-examination of Mr. Phillips in respect to the Dominguez Oil Fields stock. (T. 565.)

(B) The Court erred in failing to give weight to the testimony of Mr. Wents, whose qualifications are clearly set forth in the record and whose opinion has been used many times by the United States Government. (T. 17-18.)

VII.

The Court erred as a matter of law in determining:

(A) The fair market value on June 5, 1941, of the stock of Dominguez Estate Company to be \$900.00 per share;

(B) The fair market value on June 5, 1941, of Francis Land Company stock to be \$990.00 per share;

(C) The fair market value on June 5, 1941, of the stock of Carson Estate Company to be \$500.00 per share.

VIII.

The only witness who testified that the value of the Dominguez Estate Company stock was \$900.00 or in excess thereof was Mr. Grimes.

(A) Lack of familiarity with valuation of oil properties (T. 633) and his lack of familiarity with stock market conditions on June 5, 1941 (T. 639), disqualifies his testimony and consequently demonstrates that there is no competent evidence to support the Court's finding and decision.

(B) Furthermore, Mr. Grime's opinion admittedly was based upon a mere calculation, i.e., dividing the fair market value of the assets by the number of shares outstanding, which this and other Courts have consistently held to be error as a matter of law. [36]

(C) The so-called sales do not support the values found in the report.

(1) The only sale of Dominguez stock for cash from October 3, 1936, to the basic date was between two brothers at a figure of \$700.00 per share for two shares:

(2) The only sales of Carson stock for cash in the same period were two sales comprising 94 shares at \$300.00 per share.

(3) The so-called sales by petitioner Victoria L. Cotton in 1939 referred to on page 7 of the report were to her daughters in consideration of long-term non-interest bearing notes intended to be paid from dividends declared on the stocks in the future. The so-called sales price was exactly petitioner's

income tax basis and was used in the transfer because petitioner could not deduct a loss on such a sale. The same is true of the two sales by Lucy Rasmussen. None of these transactions is credible evidence of fair market value, for they were too removed in point of time from the basic date and they were not representative, arms-length transactions, but merely intra-family transfers.

IX.

The Court erred in failing to give weight to the testimony of petitioners' witnesses with respect to the fair market value of the stock of the Dominguez Estate Company, Francis Land Company, and Carson Estate Company.

(A) All of these witnesses testified, with uncontradicted facts to support them, that stocks were selling on the basic date at substantial discounts from the fair market value of their underlying assets. Mr. Phillips, one of respondent's witnesses, testified to the same fact and applied a 25% discount. (He erred, however, in failing to apply the discount to the oil properties.) [37]

(B) Congressional enactment requires that consideration be given in valuing unlisted stock to the selling price of comparable listed securities. Respondent admits this on brief. (Page 104.) All of petitioner's witnesses made such comparisons with comparable stocks. None of respondent's witnesses did so.

X.

The Court erred as a matter of law in failing to determine:

(A) The fair market value on June 5, 1941, of the stock of Dominguez Estate Company to be not in excess of \$400.00 per share;

(B) The fair market value on June 5, 1941, of the stock of Francis Land Company to be not in excess of \$420.00 per share;

(C) The fair market value on June 5, 1941, of the stock of Carson Estate Company to be not in excess of \$230.00 per share.

XI.

Although the Honorable Judge who rendered the opinion in the above entitled matter states that all factors of valuation were considered, it appears affirmatively from the opinion that said Honorable Judge based his conclusion as to the value of the shares of stock involved in the instant matter solely on the value (erroneously determined) of the assets owned by the various corporations.

Wherefore, it is respectfully prayed that this motion be granted.

/s/ A. CALDER MACKAY,
/s/ ARTHUR McGREGOR,
/s/ HOWARD W. REYNOLDS,
/s/ ADAM Y. BENNION,

Counsel for Petitioners.

/s/ HUGH G. ARNOLD,
Of Counsel.

Filed Aug. 19, 1946.

Denied Aug. 20, 1946. Signed Byron B. Harlan,
judge. [38]

[Title of Tax Court and Causes.]

MOTION FOR REVIEW OF REPORT
BY THE FULL COURT

Whereas, the petitioners above named have filed a motion with this Honorable Court to set aside and vacate the report entered herein on July 22, 1946, and to set the proceedings for rehearing at Los Angeles, California; and [41]

Whereas, said petitioners have filed another motion with this Honorable Court seeking a reconsideration of said report in the event the first motion hereinabove mentioned should be denied; and

Whereas, in the event this Honorable Court should deny both the above motions it is believed that a miscarriage of justice will result that can be corrected only by a review of said report and the proceedings by the full Court;

Now, Therefore, said petitioners, by and through their counsel, respectfully move, upon the grounds set forth hereinbelow and for the reasons set forth in the memorandum attached hereto and made a part hereof, that said report entered by Judge Harlan in the above entitled proceedings under date of July 22, 1946, be reviewed by the full Court.

As grounds for this motion petitioners allege as follows:

I.

The Court erred as matter of law in finding and deciding that Dominguez Estate Company was a holding company.

II.

The Court erred as matter of law in finding and deciding that Dominguez Estate Company was "not an operating company." [42]

The record is replete with evidence showing that the Dominguez Estate Company was not a holding company but was in fact an operating company. The stipulation and exhibits show that this company was purchasing, selling, developing and operating its real properties. Its rentals from buildings owned and operated amounted to in excess of \$180,000.00 for each of the four years immediately preceding the year 1941, while its expenses of operating such buildings for the same period were in excess of \$125,000.00 per year; and for the five months' operations in 1941 its rental income amounted to \$80,429.72 and its expenses amounted to \$37,836.70. Its income from building operations for the period from 1927 to June 5, 1941, amounted to \$1,071,896.72 and its rental expenses amounted to \$700,927.02. General and administrative expenses, in addition to those stated above, exceeded \$100,000.00 in each of the four years preceding 1941. Its ranch income from 1927 through June 5, 1941, amounted to in excess of \$400,000.00; its activities in the purchasing and selling of securities and in taking oil in kind and handling and disposing of it also negative the idea

that it was not an operating company. [Stip. and Ex. 4-D.]

III.

The Court erred as a matter of law in finding and deciding that the fair market value of the oil properties of Dominguez Estate Company was \$4,500,000.00 for the following reasons:

(A) There is no competent evidence to support this value.

(1) All the witnesses except Mr. Grimes and Mr. Phillips testified to a value lower than \$4,500,000.00.

(a) Mr. Grimes admittedly was not qualified as a petroleum engineer. [T. 633.]

(b) Mr. Grimes has "had very slight experience with oil properties." [T. 633.]

(c) Mr. Grimes' testimony with respect to the oil properties is based solely on a comparison of stock market ratios for 1940 and he admittedly had no "familiarity" with stock market conditions at the basic date, to-wit, June 5, 1941. [T. 639.]

(d) Mr. Grimes' opinion took into account the earnings from oil only in 1940 and ignored the estimated future income as stipulated by the parties. [T. 611-13.]

(e) Mr. Phillips was not familiar with the evidence, having based his opinion only on Exhibit 11-K-2. [T. 548-9.]

(f) Mr. Phillips admittedly was not an oil engi-

neer and claimed no experience in valuing oil properties. [T. 572.]

(g) Mr. Phillips' testimony as to the value was based upon a misconception of a "formula" he stated he had seen used by engineer Paine. [T. 545.]

(B) The Court erred in assuming that Mr. Eitner testified that the fair market value of the oil properties of Dominguez Estate Company was \$4,988,600.00.

(1) Mr. Eitner admittedly had "no experience" in connection with valuing of oil properties. [T. 333.] The value of the oil properties of Dominguez Estate Company of \$4,988,600.00 ascribed in the opinion to Mr. Eitner was not fair market value but merely "present worth," which was used only to make a comparison of reflected stock values in a transaction handled by Mr. Eitner's firm in 1938. This transaction involved the Dominguez Oil Fields Company. Mr. Paine had made a "present worth" determination of \$66.00 per share for the stock of this company. Mr. Eitner's firm, Blythe & Company, had purchased the stock of Dominguez Oil Fields Company for \$32.50 per share, or 50% of the "present worth." [T. 341.]

(C) The Court in determining the value of the oil royalties of Dominguez Estate Company erred in failing to give proper consideration to the income tax burden on the estimated future income of the oil properties. The Tax Court, as well as the

Courts, has universally recognized that in valuing oil properties, and particularly in valuing the estimated future probable income therefrom, consideration must be given to the [45] estimated future taxes which would reduce the amount of return to an investor.

(1) Mr. Grimes, government witness, was asked the following question and gave the following answer:

“Q. * * * Is it a fact, Mr. Grimes, that the higher the taxes, particularly the higher the taxes on future income, the less the value would be, isn't that a fact?”

“A. Why, yes. I think that is self-evident.”

(2) Mr. Grimes was also shown a copy of his book on valuation and was asked the following questions and he gave the following answers:

“Q. On page 99 I want to call your attention to just one item here: ‘The imposition of an income tax serves not only to reduce the amount of future income which the investor retains from the yield of the income producing property, but also to reduce the net earnings of sinking funds set aside to cover the return of the initial investments.’ You are still of that same opinion, aren't you?”

A. Yes.

Q. And I will read you also another one here, where you said that: ‘But when depreciation or

other deductions in the nature of a capital return operate to reduce the income subject to tax, and the price which an investor is willing to pay for a property is considered as determined on the [46] choice of a future net yield after payment of the tax on income and proper provision for the return of capital, the problem is much more complex, as the value sought depends upon the amount of future tax.' You still maintain that same view as expressed in that? A. Yes, I do."

(3) An excerpt from Moody's of May 5, 1941, Volume 33, No. 18, reads as follows:

"Sagging prices without any heavy liquidation were seen in last week's stock market. Many stocks touched new lows. No startling news accompanied this market reaction, which seems to be due partly to war conditions involving visions of higher taxes. It has been almost universally expected that the normal taxes of corporations would be increased from 24 per cent to 30 per cent; in fact, many corporations included the rate of 30 per cent in their reports for the first quarter. It was proposed that this increase could be accomplished by imposing a surtax of six per cent on top of the normal tax of 24 per cent." [T. 647.]

(4) See also G. C. M. 45 C. B. V-1, 65.

(D) The Court erred as a matter of law in giving any credence to the testimony of respondent's witness Evans in that—

(1) Mr. Evans was not familiar with the

terms of the Reyes lease, although he admitted [47] it would have a bearing on valuation. [T. 396.]

(2) Mr. Evans did not give any consideration or effect to the income tax burden on the estimated future income of the oil properties. [T. 399-401.]

(E) The Court erred as a matter of law in giving any credence to the testimony of respondent's witness Webb in that—

(1) Mr. Webb was not a qualified engineer and claimed no such qualification. [T. 405.]

(2) Mr. Webb was not familiar with the Reyes lease. [T. 417.]

(3) Mr. Webb was not familiar with the record, having been given for consideration only Exhibit 11-K-2. [T. 406.]

(4) Mr. Webb did not give consideration or effect to the income tax burden on the estimated future income of the oil properties. [T. 418.]

(5) Mr. Webb admitted to Judge Mellott that his method of 100 times monthly pay-out "is a very erroneous way to figure values." [T. 418.]

(6) Mr. Webb expressed no opinion of value in dollars and cents. [T. 416, 420.] [48]

(F) The Court erred as a matter of law in giv-

ing any credence to the testimony of respondent's witness Mr. Pemberton in that—

(1) Mr. Pemberton was not familiar with the oil properties. [T. 429.]

(2) Mr. Pemberton was not familiar with the evidence, having been shown only Exhibit 11-K-2. [T. 428.]

(3) Mr. Pemberton did not give consideration or effect to the income tax burden on the estimated future income of the properties. [T. 432.]

(G) The Court erred as a matter of law in giving any credence to the testimony of respondent's witness Clute in that—

(1) Mr. Clute was not familiar with the properties to be valued.

(2) Mr. Clute did not give consideration or effect to the income tax burden on the estimated future income of the oil properties. [T. 464.]

(3) Mr. Clute's valuation was merely a mathematical formulized computation. [T. 444.]

(H) The Court erred as a matter of law in giving any credence to the testimony of respondent's witness Mr. Corby in that—

(1) Mr. Corby was not familiar with the properties. [T. 481.] [49]

(2) Mr. Corby was not familiar with the

evidence, having knowledge of only Exhibit 11-K-2. [T. 475.]

(3) Mr. Corby did not give consideration or effect to the income tax burden on the estimated future income of the oil properties.

(4) Mr. Corby's testimony with respect to the pay-out is contrary to the testimony of all the other witnesses. [T. 472.]

(1) The Court erred as a matter of law in giving any credence to the testimony of respondent's witness Phillips in that—

(1) Mr. Phillips was not a qualified engineer and claimed no such qualification. In fact, he stated that he was "not equipped to pass upon the fair market value of oil properties." [T. 546.]

(2) Mr. Phillips was not familiar with the properties of the Dominguez Estate Company.

(3) Mr. Phillips was not familiar with the evidence, having been shown only Exhibit 11-K-2. [T. 548-9.]

(4) Mr. Phillips did not give consideration or effect to the income tax burden on the estimated future income of the oil properties.

(5) Mr. Phillips' testimony was based purely upon an erroneous misconception of a formula which did not exist. [T. 686.]

(6) Mr. Phillips, although not qualified to determine the value of oil properties, errone-

ously [50] attempted to reflect the value thereof in the stock. While discounting the stipulated fair market value of the other assets of Dominguez Estate Company by 25%, he allowed no such discount to the value, arrived at by erroneous formula, of the oil properties.

(J) The Court erred as a matter of law in giving any credence to the testimony of respondent's witness Mr. Grimes in that—

(1) Mr. Grimes admitted that he was not an oil engineer and had had very slight experience with oil properties. [T. 633.]

(2) Mr. Grimes, in arriving at his value, did not give consideration or effect to the income tax burden on the estimated future income of the oil properties, although he admitted that the higher the taxes on future income the less the value would be. [T. 642.]

(3) Mr. Grimes, in arriving at his value of the royalties of Dominguez Estate Company, erroneously used the earnings for 1940 of several companies. The value of oil properties in California can hardly be determined by the New York stock market, with which Mr. Grimes was unfamiliar.

(4) Mr. Grimes, in arriving at his value of the stock of Dominguez Estate Company, did not even claim familiarity with the stock market conditions on June 5, 1941. In fact, he disclaimed familiarity. [T. 639.] [51]

(5) Mr. Grimes failed to take into consideration the increase in taxes that was threatened during the spring of 1941 and that was imminent on the basic date, to-wit, June 5, 1941. [T. 647.]

(6) Mr. Grimes, in arriving at a fictitious reflected value for the oil properties of Dominguez Estate Company, added such erroneous value to the balance sheet without making any discount whatsoever, and merely divided the total value of the assets by the number of shares, a method of valuation which has been consistently repudiated by The Tax Court. [T. 674.]

(7) Mr. Grimes erroneously failed to take into consideration the fact that the minority stockholder has no right to force liquidation and he based his value of the stock upon the liquidating value. He admitted that his opinion as to the fair market value would not be the same to an outsider "who was in no manner connected with the family." He stated that under such circumstances he could not base a value on the asset value.

(8) Mr. Grimes' value is based entirely upon a mathematical computation, having no relation whatsoever to the elements which The Tax Court has considered necessary in determining fair market value, nor to the elements required by the Commissioner's Regulations to be considered. [52]

IV.

The Court erred as a matter of law in determining that the oil royalties of Dominguez Estate Company had a value at the basic date, June 5, 1941, of \$4,500,000.00 in that there is no evidence in the record to sustain such value. The highest value for the oil properties of Dominguez Estate Company that was given by any witness was \$4,450,000.00, and that was by Mr. Clute, whose testimony is entirely unreliable from a legal standpoint.

V.

The Court erred as a matter of law in failing to find and decide that the oil properties of the Dominguez Estate Company on June 5, 1941, had a value not in excess of \$3,000,000.00.

VI.

The Court erred in failing to give credence to the testimony of Messrs. Wents and Paine.

(A) Each of these witnesses was qualified in every respect, and as to Mr. Paine, admitted to be qualified by respondent's own witnesses. He used the method in determining the value of the oil properties that has been generally accepted in the United States and particularly in the State of California.

(1) Mr. Phillips admitted that his firm had great confidence in Mr. Paine's ability and had used him on many occasions. [T. 545.] [53]

(2) Mr. Pemberton in his testimony veri-

fied the method adopted by Messrs. Paine and Wents. [T. 431.] The method, admittedly correct by Mr. Pemberton, proved conclusively that Mr. Pemberton's value arrived at by the application of this particular method would have been approximately \$3,000,000.00, the same as the value given by Mr. Paine, if Mr. Pemberton had considered all the facts of record, and particularly the \$1.13 price per barrel of oil for Dominguez oil.

(3) The method was proved to be correct by a comparison with the two most comparable transactions in Southern California in recent years, namely, the Grubb Estate sale and the sales of Dominguez Oil Fields Company stock, both of which took place in 1938.

(a) Mr. Pemberton testified on direct examination that he used the same method of figuring here as he had in the Grubb Estate sale. [T. 424.] He admitted on cross-examination that the current revenue derived from the Grubb Estate oil was \$1.57 per barrel; and that the sales price of the royalty reflected a value of oil in the ground of 61c per barrel, or approximately 38% of the price the oil was bringing at the surface. [T. 425-6.]

(b) On a comparable method, since the Dominguez oil is stipulated to have been [54] \$1.13 oil at the surface, the oil in the ground should be valued at 43.2c per barrel, or 38% of \$1.13. Mr. Paine correctly testified, without contradiction, that this ratio of 38% between the value of oil in the ground

and the price it brings at the surface is a fixed, constant ratio, because as the price at the surface varies the value of the oil in the ground will vary accordingly. [T. 694.]

(c) Mr. Paine's value of \$3,000,000.00 reflected a value of 40c per barrel in the ground. [T. 159.] This was also admitted by Mr. Grimes. [T. 668.]

(d) Mr. Pemberton, although admitting that the method was a sound one, could not and did not make this comparison, for he did not even know that the Dominguez oil was \$1.13 per barrel oil. He knew nothing about the barrels. [T. 428.]

(e) Mr. Paine's method of substantially discounting present worth is also supported by the testimony of Mr. Pemberton, as well as by cross-examination of Mr. Phillips in respect to the Dominguez Oil Fields stock. [T. 565.]

(B) The Court erred in failing to give weight to the testimony of Mr. Wents, whose qualifications are clearly set forth in the record and whose opinion has been used many times by the United States Government. [T. 17-18.] [55]

VII.

The Court erred as a matter of law in determining—

(A) The fair market value on June 5, 1941, of the stock of Dominguez Estate Company to be \$900.00 per share;

(B) The fair market value on June 5, 1941,

of Francis Land Company stock to be \$990.00 per share;

(C) The fair market value on June 5, 1941, of the stock of Carson Estate Company to be \$500.00 per share.

VIII.

The only witness who testified that the value of the Dominguez Estate Company stock was \$900.00 or in excess thereof was Mr. Grimes.

(A) Lack of familiarity with valuation of oil properties [T. 633] and his lack of familiarity with stock market conditions on June 5, 1941 [T. 639], disqualifies his testimony and consequently demonstrates that there is no competent evidence to support the Court's finding and decision.

(B) Furthermore, Mr. Grimes' opinion admittedly was based upon a mere calculation, i.e., dividing the fair market value of the assets by the number of shares outstanding, which this and other Courts have consistently held to be error as a matter of law. [56]

(C) The so-called sales do not support the values found in the report.

(1) The only sale of Dominguez stock for cash from October 3, 1936, to the basic date was between two brothers at a figure of \$700.00 per share for two shares.

(2) The only sales of Carson stock for cash in the same period were two sales comprising 94 shares at \$300.00 per share.

(3) The so-called sales by petitioner Victoria L. Cotton in 1939 referred to on page 7 of the report were to her daughters in consideration of long-term non-interest bearing notes intended to be paid from dividends declared on the stocks in the future. The so-called sales price was exactly petitioner's income tax basis and was used in the transfer because petitioner could not deduct a loss on such a sale. The same is true of the two sales by Lucy Rasmussen. None of these transactions is credible evidence of fair market value, for they were too removed in point of time from the basic date and they were not representative, arms-length transactions, but merely intra-family transfers.

IX.

The Court erred in failing to give weight to the testimony of petitioners' witnesses with respect to the fair market value of the stock of the [57] Dominguez Estate Company, Francis Land Company, and Carson Estate Company.

(A) All of these witnesses testified, with uncontradicted facts to support them, that stocks were selling on the basic date at substantial discounts from the fair market value of their underlying assets. Mr. Phillips, one of respondent's witnesses, testified to the same fact and applied a 25% discount. He erred, however, in failing to apply the the discount to the oil properties).

(B) Congressional enactment requires that con-

sideration be given in valuing unlisted stock to the selling prices of comparable listed securities. Respondent admits this on brief. (Page 104.) All of petitioners' witnesses made such comparisons with comparable stocks. None of respondent's witnesses did so.

X.

The Court erred as a matter of law in filing to determine—

(A) The fair market value of June 5, 1941, of the stock of Dominguez Estate Company to be not in excess of \$400.00 per share;

(B) The fair market value on June 5, 1941, of the stock of Francis Land Company to be not in excess of \$420.00 per share; [58]

(C) The fair market value on June 5, 1941, of the stock of Carson Estate Company to be not in excess of \$230.00 per share.

XI.

Although the Honorable Judge who rendered the opinion in the above entitled matter states that all factors of valuation were considered, it appears affirmatively from the opinion that said Honorable Judge based his conclusion as to the value of the shares of stock involved in the instant matter solely on the value (erroneously determined) of the assets owned by the various corporations.

Wherefore, it is respectfully prayed that this motion be granted.

A. CALDER MACKAY,
ARTHUR MCGREGOR,
HOWARD W. REYNOLDS,
ADAM Y. BENNION,

Counsel for Petitioners,

HUGH G. ARNOLD,
Of Counsel. [59]

MEMORANDUM IN SUPPORT OF MOTION
FOR REVIEW OF REPORT BY THE
FULL COURT

I.

We are aware that the full Court rarely reviews a valuation question, but it is earnestly believed by petitioners that justice can be achieved in no other way in the present case, where the Judge who heard the evidence is not available to decide the issue, where a clear-cut legal question has been decided against petitioners inferentially and without any reasons being given or without even a statement of the issue, where the accepted meaning of fair market value, recognized by the Judge at the hearing, has apparently been abandoned in deciding the case, where the elements required to be considered by the regulations and decided cases have been slighted, where expert testimony introduced by both parties has been disregarded, and where the factors alleged to have been considered in the report can easily be shown not to support the values found therein.

II.

The opinion part of the report begins on page 8 by apparently ridiculing the “imaginary individuals” who traditionally have been assumed to exist in fair market valuations. In so doing, the report departs from the definition [60] of fair market value given by Judge Mellott during the trial and which the petitioners had a right to assume would be

adopted in the decision of the case. Judge Mellott stated, in apparent criticism of a witness for respondent who had merely divided the value of the assets by the number of shares outstanding, “* * * considering fair market value to mean, as no doubt what it means, * * * the price at which the hypothetical willing buyer, having knowledge of all of the facts, and the seller, having knowledge of the facts—neither being under any compulsion—would trade.” [T. 603.]

III.

The opinion proceeds on page 9 to state that since there were “speculative and argumentative” factors involved, the inclination is merely to accept the Commissioner’s determination of value. And it is stated that this was not done because (1) the Commission had abandoned his own determination, and (2) certain of the expert testimony produced by the Commissioner himself (namely, two out of three of his witnesses) failed to support his own determination. Notwithstanding these protestations, the report is tantamount to an acceptance of the Commissioner’s abandoned determination, for his determination was \$950.00 per share and the report finds a value of \$900.00 per share. [61]

The value of the stock in question turns largely upon the value determined for Dominguez stock, which in turn is largely governed by the value of its oil properties (valued in the report at \$4,500,000.00). The Commission never made a determination of the value of the oil and hence as to it there was no presumptive correctness.

Furthermore, any valuation case—and particularly one involving oil properties—must of necessity embrace factors about which there can be speculation and argument. A valuation is essentially an attempt to prophesy the future. This being inherent in every valuation case, does the present report mean to intimate that a taxpayer may not secure the independent judgment of this Honorable Court founded upon credible and competent evidence? Are all taxpayers condemned to the whim of the Commissioner in valuation matters because he can argue and speculate over matters where even his own witnesses fail to support him? The finality attributed by Dobson to The Tax Court's findings in such matters is tragic for taxpayers if this is to be the extent of their day in court.

The Tax Court has never to the knowledge of the undersigned indulged in its inclination, if any, to escape the responsibility of passing upon the factors recognized as essential in determining fair market value. The statutory presumption [62] does no more than make the taxpayer come forward with his proof. A record of 765 pages of transcribed testimony of 14 experts and printed briefs of 290 pages cannot legally be so easily ignored, even though such record may contain "speculative and argumentative" factors. As Justice Learned Hand of the Second Circuit Court of Appeals stated (*Guggenheim v. Helvering*, 117 F. (2d) 469, 474):

"* * * In appraising property of this kind, whatever courts may say, and however they

may seek to disguise what they do, it is impossible to avoid some measure of speculation. * * * A judicial duty which is inherently subject to such shortcomings must not stop half way; it is no more speculative to appraise the proper discounts for the delays, the risks and the liabilities involved than to appraise the shares themselves. And of all possible appraisals that alone was sure to be wrong which the Board chose; a doctrine so enamored of accuracy that it must abdicate is the most irrational of all. The law is not so helpless; situations again and again present themselves where, after all shifts are exhausted, rather than permit certain injustice, a tribunal will make the best reckoning that the facts admit though fully conscious of its infirmities. * * *

Randolph E. Paul, in his work on Federal Estate and Gift Taxation, Vol. II, expresses similar thought (pp. 1217-23):

“Value is essentially and peculiarly a difficult question of fact, with the burden of proof upon the taxpayer. Indeed, it is in one sense even more than a question of fact; it is a question of prophecy, a matter of opinion and judgment. It has even been said that valuations are of the stuff that dreams are made of. Thus, the value of property is hardly even a simple question, even when market quotations are available as a criterion. It is unsafe to neglect any apparent factor. And it is the composite of all factors involved in a single case that

should lead to a conclusion rather than an impractical attempt to assign to any particular factor a precise weight or to define its relative emphasis or importance in a total equation of valuation. Individualized treatment of each problem is essential. The variety of things affecting value cannot be counted by any available mathematics; we soon reach 'potent imponderables.' The cases are recalcitrant. They vary without rules of variation. Market value 'is so dependent upon time, places, conditions, and people that that which is a good rule in one case may be no rule under other circumstances.' One case requires the valuation of real estate, another a remainder interest in personalty. Another case has its penumbræ [64] of stock market operations. We are driven from an almost nostalgic desire for simplicity and certainty to a realistic conclusion that 'no cut and dried formula,' or definite circumscribed method or rule, will do the job for all cases. Courts must do as well as they can with a 'composite mass' of evidence, 'giving judicial consideration to the evidence properly in the record.'

The problem goes deeper than the variability of subjects of valuation. Subjects of valuation may on occasion be static; the inventory of properties calling for valuation is in large part composed of the things our grandfathers possessed. But value, in the very nature of things, is in constant flux; a transverse time factor complicates the problem and awkwardly poses the question of date of valuation. Dates are important, even crucial, in a chang-

ing mid-twentieth century world. One date means one thing, another date another thing, in the shifting—indeed, the chaotic—economic world from which valuation evidence must be taken. The job of the valuation expert, or tribunal charged with a duty to value, is to find the resultant of many conflicting forces. It must do the best it can with an imperfect record, and with a faulty perception, because in the law the courts must strive toward answers that will do. The thing must be decided. [65]

* * * Attempted perfectionism would paralyze ‘the function of deciding,’ and a refusal to exercise judgment would be an error of law. The courts may not shirk their duty of deciding because it is difficult to get competent evidence. Where there are no fields of black and white, formalistic mathematical accuracy would be ‘delusive exactness.’ One must not be ‘enamored’ of accuracy, for the best valuation is nothing better than a reasonable approximation reached by the *via media* of compromise and reconciliation of many practical and logically conflicting pressures and shades of contradiction. Syllogistic logic is too simple a tool. Something less artificial, some quality of discretion, something like common sense, a process of inarticulate and unconscious judgment, is needed. The factor of intuition must and does join forces in reaching an answer that is then dressed in legalistic language and in formally stated principles of valuation.”

IV.

Aside from speculative and argumentative factors,

however, there are a few facts which demonstrate that there is no credible evidence to support a value of \$900.00 and hence the report is legally insupportable.

(1) Tax cases must be decided upon the record made at the hearing, particularly where the [66] Judge who heard the case has since resigned and the case is decided by a new Judge. Expert testimony cannot be arbitrarily disregarded. Yet the present report, without a word of justification, rejects the testimony of six experts on the question of the value of the stocks—five presented by petitioners and one by respondent.

Counsel have never seen a case where a value was found more favorably to a party than was testified to by his own expert witnesses. Yet in the present report of a value of \$900.00 per share is found notwithstanding that two of the three experts called by respondent expressed opinions lower than that figure. One of respondent's witnesses (Mr. Phillips) expressed an opinion of \$759.00 per share; and even this opinion was based upon an erroneous and inflated value for the oil.

(2) There was a tremendous difference between the value determined by respondent (\$950.00) and the value contended for by petitioners (\$400.00). The respondent sought to defend his value upon the bare legal argument, which he frankly admits on brief, that it is permissible to value the stock by dividing the asset value by the number of shares outstanding, citing a few cases where this has been

done involving very closely-held, non-operating companies organized in the main for tax avoidance purposes. [67]

The petitioners joined issue with such a revolutionary principle and contended that it would be error as a matter of law in the case of an operating company, the control of which is divided between two large families of first, second and third cousins and with the balance of power in a disinterested trustee, to value the stock by simply dividing the assets by the number of shares.

No one reading the present report could even surmise that such an issue had been presented for decision. It is not mentioned. But the finding is a tacit approval of respondent's contention, for the value found is within \$3.00 of the amount derived by dividing the fair market value of the assets as determined in the report by the number of shares outstanding (\$902.91).

(3) The concluding paragraph of the report states that consideration had been given to past and future earnings. No mention is made in the findings or the opinion that current earnings were only \$48.00 per share. There is no finding and no comment upon uncontradicted evidence presented by petitioners, based upon stipulated future income from oil, that earnings for the next ten years after depletion would be less than \$30.00 per share. No sufficient reasons are given in the report to justify a value nearly 20 times current earnings and 30 times prospective earnings. [68]

(4) A fact that was testified to by six witnesses, including one of respondent's own witnesses, is that on the basic date the stocks of the very best companies were selling at substantial discounts from the fair market value of their underlying assets. This was no "speculative" or "argumentative" factor, but a fact agreed upon by witnesses on each side. The report does not even mention this fact and in effect ignores it by valuing the stock at the value of the underlying assets.

(5) The report states that the evidence has been analyzed under the heads of (a) petitioners' witnesses, (b) respondent's witnesses, (c) intra-family sales, and (d) appraised value by companies and officers. They cannot support a value of \$900.00 per share.

(a) The report obviously rejects the opinions of petitioners' five witnesses, for their values ranged from \$304.00 to \$420.00 per share, the highest less than one-half the value determined in the report.

(b) The opinions of two of respondent's three expert witnesses fail to support the value found in the report, for they were both lower. One was \$759.00 per share and the other \$861.46. Respondent's other witness, who was the only one of eight witnesses called [69] by either party who valued the stock as high as that found in the report, was Mr. Grimes, an employee of the Bureau of Internal Revenue, who had no familiarity with stock market conditions at June 5, 1941 [T. 639], and who admitted on the witness stand that he valued the

stock solely by dividing the value of the assets by the number of shares outstanding. On page 674 of the transcript:

“Q. * * * did I understand you to say that it was your opinion that the value per share of the Dominguez is equivalent to the fair market value of the total assets divided by the total number of shares outstanding?

A. That is right.”

In the recent case of *Richardson v. Commissioner* (C. C. A.—2), 151 F. (2d) 102, 105, the Court stated:

“To me, at least, the findings and opinion when read together strongly suggest that the valuation adopted was based upon some such theory as was enunciated by the respondent’s experts whereby the controlling criterion of value for stock such as this was taken to be not its fair market value as provided in the applicable regulations of the Treasury Department but rather some notion of ‘intrinsic’ value. If so, the holding was erroneous. [Citing several cases.]” [70]

(c) The report gives none of the facts surrounding the so-called “interfamily sales” which demonstrate that they were not representative sales and that they have no bearing upon fair market value.

1. The only sales of any of the stocks of the three companies for cash from October 3, 1936 to June 5, 1941, or for nearly five

years prior to the basic date, were two shares of Dominguez which were sold by a Watson to his brother for \$700.00 per share, and 88 shares of Carson for \$300.00 per share, six of said shares being purchased from outside interests. Yet the report finds a value of \$900.00 for Dominguez stock and \$500.00 for Carson stock. It is perfectly obvious that these sales do not support the values found, and yet, of the few intra-family transactions that took place in five years, they are the only ones which had the remotest element of a bargain and sale in that cash actually changed hands.

2. The only other sales of Dominguez stock in the same period were two sales by mothers to their children, involving 99 shares each, at figures which represented the income tax cost bases of the mothers and these figures were used because it was desired to show neither gain nor loss inasmuch as losses could not be deducted on such [71] transactions. The consideration for such shares were long-term non-interest bearing notes of the children which were intended to be paid out of future dividends on the stock. It is an error of fact and law to rely upon such transactions as reflecting fair market value.

3. There were no sales of Carson stock during the same period except the two sales in 1935 and 1936 for \$300.00 referred to hereinabove. A value of \$300.00 in 1936 supports

petitioners' contention that the value did not exceed \$230.00 per share on June 5, 1941, for the oil properties of Dominguez had been depleted by more than \$6,000,000.00 in royalties from 1936 to 1941. Certainly there is nothing to support a value of \$500.00 in 1941.

4. There was no sales of Francis stock in the same period except two sales by mothers to their children under exactly the same circumstances as set forth in "2." above.

(d) "Intercompany ratings" are also said to have been considered in the report, consisting of four items. Three of them are the figures at which Dominguez and Francis shares were carried on the books of other companies; in other words, book value. How [72] utterly worthless they are in determining fair market value is shown by the fact that shares of Dominguez were carried on the books of Francis at \$1,019.00 per share, while at the same date the Dominguez shares owned by Carson were carried on its books at \$722.00 per share. And at the same time Francis stock was carried on Carson's books at \$1,137.00 per share, although no one has ever contended that Francis stock is more valuable than 1.1 times that of Dominguez per share. Book values are notoriously unreliable in ascertaining fair market value, as these figures demonstrate, and are wholly irrelevant in a case where a tremendous amount of evidence has been introduced to prove the fair market value.

The other so-called "intercompany rating" is said

to be the official report of Dominguez to its stockholders in 1941, stating that the appraised value of the stock of Dominguez was \$1,000.00 per share.

We will pass the point that the statement referred to was made in a report dated March 28, 1940 [Ex. C. C.], covering the year 1939, instead of in the year 1941. In view of the weight apparently accorded this fact by Judge Harlan it is important to review the statements [73] made by Judge Mellott when counsel for respondent offered it [see T. 499]:

“The Court: Well, you have hardly answered the question. You are valuing, or we are attempting to value, in this case the stock of this company as of June 5, 1941. Now, as to a value placed upon the stock by officers of the corporation at some earlier date, it would probably be hearsay and be mere speculation or opinion of the officers. They may have been entirely too optimistic or they may have been entirely too pessimistic. I fail to see where it has a great deal of materiality, assuming that there is any competency at all, although I am reluctant to exclude it from evidence if you think there is some real connection that can be made.”

Thus, the Judge who heard the case considered this evidence as probably hearsay, of no great materiality, if competent at all, and as mere speculation on the part of an officer.

Furthermore, the opinion overlooks the explanation of Mr. Cotton, the president of the company

and author of the statement, who testified under other oath [T. 742] that prior to the present suit there had been no appraisal of the Dominguez stock; that his use of the words "appraised value" was unfortunate since he was referring to "the figure that was set forth by [74] the Government in their claim for taxes in the Francis estate and on which tax was paid." That was in 1934.

To substantiate the fact that there had been no appraisal made, counsel for respondent read into the record a resolution adopted by the board of directors of Dominguez on August 13, 1941 (after our basic date), as follows [T. 494-6]:

"The chairman, Mr. H. H. Cotton, then brought up the matter of an appraisal on the Dominguez Estate Company stock, stating that in his opinion he felt that an appraisal of the assets should be made of the Dominguez Estate Company to determine the present value of its stock. * * *"

Thus, the uncontradicted evidence in this record proves that the appraised value relied upon in the report was nothing more than a figure adopted by the Commission himself in 1934, seven years before the gifts in our case. And that Mr. Cotton did not acquiesce in that exorbitant figure even in 1934 (and it should be remembered that more than \$6,000,000.00 in oil royalties were received between 1934 and 1941, thereby depleting the company's assets to that extent) is shown in the report of

the same Mr. Cotton to the stockholders in 1937, where he stated:

“* * * It seems that it should be the policy of this company to dispose of as [75] rapidly as possible a large percentage of these unproductive lands both from the standpoint of Dominguez Estate Company as a corporation, but more from the point of the stockholders of this corporation because, as was exemplified in the Estate of Mrs. Francis, the values of the stock of this company are predicated on the values of the land as assessed by Government employees, and the value of the stock of Mrs. Francis was increased a tremendous extent by valuations that surely did not exist and many hundreds of thousands of dollars were paid in inheritance taxes.”

This was in keeping with action taken by Mr. Cotton upon another occasion, in May 1936, showing that he certainly did not believe the stock was worth \$1,000.00 even at that early date. Counsel for respondent proved that another Company had offered to sell Dominguez 980 shares of Dominguez stock at \$800.00 per share. This offer was not accepted and Mr. Cotton explained why on page 741 of the transcript:

“Because I advised the directors that the price was way out of line and too high. At the same time the directors authorized me to negotiate with the Del Amos as to the price of the stock. After talking it over with Mr. Del

Amo, he finally withdrew his offer to sell.” [76]

Hence, in giving weight to the so-called appraised value of the board of directors the report relies upon incompetent speculation which is full explained in the record as being entitled to no credence whatever.

These, then, are the four headings under which the report analyzed the evidence. We ask in all sincerity: Is there any sound justification whatever in all the above for the values determined in the report?

V.

In view of the foregoing it is respectfully submitted that there is not one reason given in the report to justify the values found therein and that, on the contrary, the report shows on its face that there is no credible evidence to support it. Petitioners believe that the proceedings should be reviewed by the full Court and reconsidered in the light of the foregoing.

A. CALDER MACKAY,
ARTHUR MCGREGOR,
HOWARD W. REYNOLDS,
ADAM Y. BENNION,
Counsel for Petitioners,

HUGH G. ARNOLD,
Of Counsel.

[Title of Tax Court and Cause.]

ORDER

The motion of the petitioner filed on August 19, 1946, asking for review by the full Court of the Memorandum Findings of Fact and Opinion of Division 11 (Harlan), is hereby denied.

/s/ J. E. MURDOCK,

Acting Presiding Judge.

Dated: Washington, D. C., August 21, 1946. [78]

[Title of Tax Court and Cause.]

DECISION

Pursuant to the memorandum findings of fact and opinion entered herein on July 22, 1946, directing that decision be entered under Rule 50, the respondent, on October 18, 1946, filed his computation for entry of decision and petitioner, on October 31, 1946, filed an acquiescence therein. It is therefore

Ordered and Decided: That there is a deficiency in gift tax herein for the year 1941 in the amount of \$5,214.00.

/s/ WILLIAM W. ARNOLD,

Judge.

Entered Nov. 12, 1946.

[Title of Tax Court and Cause.]

(Met pursuant to notice.)

Before:

Honorable Arthur J. Mellott, Judge.

Appearances:

A. Calder Mackay, Esq.; Adam Y. Bennion, Esq., 728 Pacific Mutual Building, Los Angeles, California, and Hugh G. Arnold, Esq., 631 South Spring Street, Los Angeles, California, appearing on behalf of Victoria L. Cotton and Virginia Caldwell, petitioners.

H. A. Melville, Esq., (Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue), appearing on behalf of the Commissioner of Internal Revenue, Respondent. [82]

PROCEEDINGS

The Clerk: Docket No. 2257, Victoria L. Cotton and Docket No. 7583, Virginia Caldwell.

Mr. Mackay: Petitioner is ready.

Mr. Melville: Respondent is ready.

The Court: Will you state your appearances for the record?

Mr. Mackay: A Calder Mackay and Adam Y. Bennion for the Petitioners.

Mr. Melville: H. A. Melville for the Respondent.

The Court: You may state your case for the Petitioners.

OPENING STATEMENT ON BEHALF OF
PETITIONERS

By Mr. Mackay

Mr. Mackay: Your Honor please, in the case of Victoria L. Cotton, Docket No. 2257, the Commissioner determined a deficiency in gift tax for the year 1941 in the sum of \$7,845.75.

The gifts in question were made by Petitioner on June 9, 1941, and consisted of 200 shares of stock of a company known as Carson Estate Company. 100 shares were given to each of two donees.

The only question at issue here concerns the fair market value of these shares of stock. There is no dispute over a credit that was also given to the donees by the donor [83] on May 31, 1941, as set forth in the petition and admitted in the answer.

In her 1941 gift tax return the Petitioner reported the gifts of the 200 shares of Carson stock at a value of \$250.00 per share, a total of \$50,000.00; and in her petition has alleged that the value did not exceed \$175.00 per share, or a total of \$35,000.00.

The Respondent has determined in the notice of deficiency that said 200 shares of Carson Estate Company stock had a value on the date of gift of \$600.00 per share, or a total of \$120,000.00.

Through extended conferences, the parties have attempted to agree upon as many of the basic facts as possible. A stipulation will be presented, to which are attached Joint Exhibits numbered from 1-A to 20-T.

The factual situation is rather complex and, since

most of the factual background is reflected in the stipulation, it will assist the Court to explain at the offset what the parties have stipulated.

We are concerned here with the stock of three companies and with some oil properties. The reason for this is as follows:

The Carson Estate Company owns about four oil properties. It also owns, among its principal assets, 1,785 shares of stock of Francis Land Company (out of a total of [84] 5,000 shares outstanding). The parties have been unable to agree upon the value of the stock of the Francis Land Company or of the oil properties owned by Carson.

The principal asset of Francis Land Company is a controlling interest in another company, the Dominguez Estate Company. Francis owns 5,499 shares of the outstanding 10,499 shares of Dominguez Estate Company. The parties have been unable to agree upon the value of the Dominguez Estate Company shares.

The principal assets of the Dominguez Estate Company consists of oil properties, namely, a landowner's royalty interest in approximately 13 oil leases.

The parties have prepared a chart showing the relationship of these three corporation, their total shares outstanding, the number owned by each. This chart is Joint Exhibit 16-P attached to the stipulation. I have in my hand, if your Honor please, an extra copy of that chart and I think it might help your Honor to follow us through this labyrinth of the three corporations.

I may point out the corporations upon the left-hand side have nothing to do with this particular case. We are concerned only with the three companies, the Carson Estate Company, the Francis Land Company and the Dominguez Estate Company.

Dominguez Estate Company owns assets other than [85] the oil royalties, such as stocks, bonds, ranch real estate and city real estate; but the parties have agreed upon and stipulated the fair market value of all such assets as of the date of gift. These stipulated figures for Dominguez are shown in Joint Exhibit 1-A.

In other words, the only assets of Dominguez Estate Company upon which the parties have not agreed as to the value are the oil royalties. Evidence will be presented with respect to the value of such oil royalties.

The parties, however, have presented in the stipulation certain estimates with respect to the oil royalties. In Joint Exhibit 11-K (1) an estimate is shown of the probable future production of barrels of oil from known oil reserves owned by Dominguez Estate Company at the basic date, [86] together with the royalty share of Dominguez Estate Company therein. It will be seen from that exhibit that the total estimated figure for all of Dominguez Estate Company's known reserves is 47,790,000 barrels, and that the royalty share of Dominguez Estate Company therein is 7,992,871 barrels.

Said Joint Exhibit 11-K(1) also gives an estimate of the probable future rate of production of said

oil. I should like to call your Honor's attention, however, to a proviso in the stipulation to the effect that the estimate——

“* * * is based upon the assumption that all wells being produced on June 5, 1941, would continue to be produced to the full indicated capacity of the formation to yield the oil, and, further, that each probable productive location of said known oil reserves would be developed and produced to its full indicated capacity in accord with its probable development program.”

Joint Exhibit 11-K(2) is a computation, using the price of oil during the five months preceding the date of gift, of the probable royalty income to be derived by Dominguez Estate Company based upon the estimated production set forth in the preceding Joint Exhibit 11-K(1).

Here, again, your Honor's attention is directed to the following statement in the stipulation:

“It is understood and agreed that nothing [87] contained in said joint Exhibits 11-K(1) and/or 11-K (2) shall limit either party in presenting evidence with respect to discounts and other factors and/or methods that might be taken into consideration in determining the fair market value of said oil royalties or in presenting any evidence of such fair market value based upon other indices.”

The Court: Will you pardon an interruption? Off the record.

(Discussion off the record.)

The Court: On the record. You may proceed.

Mr. Mackay: In other words, in an effort to shorten the time of this trial, the attorneys have agreed upon an engineer's estimate of the known oil reserves, probable rate of production at full indicated capacity of the formation to yield the oil, and upon the price of oil current at the basic date, without, however, admitting or agreeing that a willing buyer would have blindly accepted such estimates.

Expert testimony will be offered to show what discounts and factors and what other indices of value would be used by a willing buyer of the oil royalties.

Petitioner believes the evidence will establish [88] that the fair market value of the oil royalties owned by Dominguez Estate Company at June 5, 1941, did not exceed \$3,000,000.00.

In the case of Francis Land Company, Joint Exhibit 2-B shows the assets and liabilities upon the values of which the parties have agreed. Your Honor will note that, aside from the 5,499 shares of Dominguez Estate Company stock owned by Francis Land Company, all of the other assets of Francis Land Company had a value of only \$83,000.00, and that its liabilities were \$85,000.00. Francis Land Company owned no oil properties. It therefore is clear that the only asset of Francis Land Company of

any consequence here—and the only one upon which the parties have not stipulated a value—is its controlling interest of 5,499 shares in Dominguez Estate Company.

Joint Exhibit 3-C is a similar statement for Carson Estate Company. Carson owned, as heretofore stated, a few oil royalties—landowner's royalties, as in the case of Dominguez Estate Company. Joint Exhibits 12-L(1) and 12-L(2) give similar estimates with respect to the oil properties as in the case of Dominguez Estate Company, and are similarly limited in scope. They reveal that the probable future barrels of production are 2,590,000 barrels, and that Carson Estate Company's royalty interest is 398,796 barrels.

Other assets of Carson Estate Company, as shown on [89] Joint Exhibit 3-C, are the 1,785 shares of Francis Land Company stock and 1,353 shares of Dominguez Estate Company stock, the values of which are at issue; and its other assets—securities, ranch real estate and other real estate—are shown at stipulated fair market values as of June 5, 1941.

In other words, the parties have agreed upon the fair market values of all assets involved in this proceeding except:

- (1) The oil properties and the stock of Dominguez Estate Company;
- (2) The stock of Francis Land Company;
- (3) The oil properties and stock of Carson Estate Company.

Various other facts have been agreed upon and are included in the joint exhibits.

4-D, 5-E, and 6-F show the earnings and dividends paid by the three companies, respectively, from 1927 through May 31, 1941. The parties have stipulated that said earnings up to December 31, 1940 are the correct earnings without taking into account percentage depletion, except for cost depletion as shown on said exhibits.

Since the companies are on the cash basis, the earnings shown on said exhibits for the five months in 1941 preceding the date of gift do not necessarily give a true [90] picture of the earnings for that period, and consequently another exhibit for each company, 4-D(1), 5-E(1), and 6-F(1), have been stipulated, showing the earnings for the entire year 1941 and 5/12ths thereof.

Joint Exhibits 7-G through 10-J show approximate allocations, so far as possible, of general and administrative expenses and earned surplus adjustments for Dominguez Estate Company and Carson Estate Company.

Joint Exhibits 13-M through 15-O are lists of the stockholders of the three corporations as of June 4, 1941.

I might state at this point that all of the companies are personal holding companies.

Joint Exhibit 16-P is the chart, a copy of which has heretofore been handed to your Honor, and the last four exhibits 17-Q through 20-T, are maps of the oil properties of Dominguez Estate Company and Carson Estate Company. We have extra copies of said maps which it may be well to refer to during the trial.

The parties have stipulated that figures as of May 31, 1941, may be taken to be the figures as of the date of gift five days later.

In the case of Virginia Caldwell, Docket No. 7583, the petitioner, on August 11, 1941, made gifts of 100 shares of Dominguez Estate Company stock and 105 shares of Francis Land Company stock. The only issue in that proceeding is [91] over the fair market value of said shares, the Commissioner having determined a deficiency in gift tax of \$18,641.51.

In her gift tax return for 1941 petitioner reported the 100 shares of Dominguez Estate Company stock at \$340.00 per share, or a total of \$34,000.00. The Commissioner determined the value to be \$950.00 per share, or a total of \$95,000.00.

Petitioner reported the value of the Francis Land Company stock at \$374.00 per share, or a total of \$39,270.00 for the 105 shares. The Commissioner determined a value of \$1,045.00 per share, or a total of \$109,725.00.

The valuation date in the Caldwell case is so close to that in the Cotton case—August 11 and June 5,—barely more than two months—that the parties feel a long trial in each proceeding would be unwarranted and an imposition upon the court.

The evidence will show, if your Honor please, that the values of each of the three stocks involved here were dependent in large measure upon the oil properties of Dominguez Estate Company and that the latter of course are wasting assets. It will also show that they were at the peak of production just

prior to the basic date and that the operation is in substance a liquidating affair. That is to say, the Dominguez Estate Company is not an oil company out in the market buying other oil fields with the idea of continuing in [92] the oil business indefinitely.

It will also be shown, if your Honor please, that the general investment market at June 5, 1941, was very unsettled and that good stocks actively traded in were selling at comparatively low figures. It will also be shown that investors are extremely hesitant to buy stock—particularly minority stock, as we have here—in closely held family personal holding companies. The evidence will show that these companies were caught in a strangling tax-squeeze, so to speak, brought about as your Honor knows, by the enactment of the personal holding company surtax. In other words, these companies are bound to be liquidating affairs for they must distribute all their earnings each year or leave them to the government in surtaxes.

If your Honor please, I apologize to my associate, Mr. Arnold, certified public accountant, associated in this case. I would like to enter his appearance. Mr. Hugh G. Arnold.

The Court: He is admitted to practice before the court?

Mr. Mackay: Yes. I would like to offer a stipulation.

Mr. Melville: May I make an opening statement, if you are through?

Mr. Mackay: I am sorry. [93]

OPENING STATEMENT ON BEHALF
OF RESPONDENT

By Mr. Melville

Mr. Melville: I think Mr. Mackay made a very excellent opening statement and has outlined to the court the issues and problems involved.

As far as the respondent is concerned I will limit mine to simply stating that probably the first decision the court will have to reach is the value of the oil royalties in the Dominguez Estate Company. As to those the government contends they are worth between \$450,000.00 and \$500,000.00.

Mr. Mackay: Stipulate that.

Mr. Melville: \$4,500,000.00 to \$5,000,000.00. Having reached whatever decision the court does with respect to the value of those oil royalties, the court will then have before it the value of all underlying assets, as well as earnings, dividends, and other factors on which to base an opinion as to the value of the stock of the Dominguez Estate Company.

As to the value of the stock of Dominguez Estate Company respondent believes that the evidence will show that that value is at least in the amount set forth in the statutory notice, or \$950.00.

Going then to the second company, the Francis Land Company, each share of stock in the Francis Land Company is represented by 1.1 shares of stock in Dominguez Estate [94] Company. The respondent, therefore, contends that the value of the stock in Francis Land Company is worth at least \$1,045.00.

Going then to the third corporation, the only underlying factors which the court might want to consider in arriving at an opinion as to the value of the Carson Estate Company stock, which is not already agreed to, is the value of the oil royalties. As to those the government believes the evidence will show a value of from \$275,000.00 to \$300,000.00.

Having arrived at such value as the court thinks proper for those oil royalties, it then has all the factors including the value of the underlying assets, earnings, dividends, so forth, on which to reach a value as to the stock of the Carson Estate Company. And as to that stock the respondent believes the evidence will show the value was at least \$600.00, which was used in the issuance of the statutory notice.

Mr. Mackay: Your Honor please, I would now like to make a formal offer of the stipulations and exhibits. You have them, I think, your Honor.

The Court: Very well.

The stipulation of facts, to which has been attached the exhibits referred to, numbered and lettered as counsel indicated, may be handed to the clerk and will be filed and [95] constitute a part of the record in this proceeding.

Mr. Mackay: I should like to offer here a stipulation signed by both parties for consolidation of these two cases.

The Court: Very well. Thank you, gentlemen. The stipulation may be filed in each of the cases.

Off the record.

(Discussion off the record.)

The Court: On the record.

Mr. Melville: I might point out at this time, your Honor, there has been a very slight error in three exhibits, but we will explain that to the court by stipulation perhaps tomorrow.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

Mr. Mackay: I will call Mr. Wents.

EVIDENCE ON BEHALF OF PETITIONESS

Thereupon, the petitioners, to maintain the averments of their petitions, introduced the following proof:

JOHN H. WENTS, JR.,

called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name for the record.

The Witness: John H. Wents, Jr. [96]

Direct Examination

By Mr. Mackay:

Q. Mr. Wents, are you a resident of Los Angeles? A. I am.

Q. You have been for some time?

A. I have.

(Testimony of John H. Wents, Jr.)

Q. How long?

A. The greater part of 19 or 20 years.

Q. Will you please tell the court your occupation?

A. I am a consulting geologist and engineer.

Q. How long have you been a consulting geologist and engineer? A. Since 1939.

Q. 1939? A. Yes.

Q. What are your educational qualifications?

A. I attended Stanford University during the years 1923-1927. I attended the University of Southern California between the years 1934 and 1939.

Q. Did you get a degree in engineering?

A. No, I did not.

Q. By whom are you employed now?

A. I am employed by myself as a consultant.

Q. As a consultant?

A. As a consultant. [97]

Q. What has your experience as a consultant been?

A. My experience as a consultant has been I went into the business in 1939. At that time I was employed by the Dominguez Estate Company, the Carson Estate Company and the Watson Land Company. Since that time I have been employed by J. Paul Getty, Harold C. Morton, C. H. Lebow and George A. McNee, George D. Nordenholt, Kohlbush & Morton, Miller & Miller, Royal Petroleum Company, Pacific American Oil Company, Sierra Oil Company, St. Francis Oil Company, H.

(Testimony of John H. Wents, Jr.)

M. Halloway, MacMillan Oil Company, George Machris (Wilshire Oil Company), Pettyjohn Drilling Company, Pacific Western Oil Company, George F. Getty, Inc., and by a number of banks, including the Corn Exchange Bank, New York.

Q. In a general way, can you tell us the scope of your activities as consulting engineer and geologist?

A. These are quite broad. As a geologist I examine and report upon potential oil properties, either improved or undeveloped or developed, semi-improved. As an engineer I oversee, superintend and plan initial development of oil properties, their production and development after the oil has been discovered and attend to many and varied details with respect to them.

I have been employed in many instances as an appraiser of oil properties and mining properties. Included in that work I have done the work for the various banks. And during the last three or four years I have been consulted and [98] employed on nearly every case that has come before the Lands Division of the Department of Justice?

Q. To determine what?

A. The fair market value of various oil and gas and mineral properties.

Q. That were taken over by the government?

A. In the process of their condemnation, yes.

Q. In that work have you had occasion to make valuation of oil royalties on oil properties?

A. In my employment, prior to the time I went

(Testimony of John H. Wents, Jr.)

into the consulting business for myself, I was employed as chief geologist and appraiser for Diversified Royalties, Ltd.

Q. When was that? A. 1934 to 1939.

Q. What were your duties there?

A. To appraise oil royalty interests that were offered to that company for purchase.

Q. What was the nature of that company's business? A. Dealers in oil royalties.

Q. Buying and selling oil royalties?

A. Buying and selling oil royalties.

Q. Did you act as consultant there in determining values?

A. I appraised many million dollars of royalties.

Q. Oil royalties? [99]

A. Oil royalties; in that capacity.

Q. Mostly, I suppose, in Southern California?

A. Yes, in Southern California. Probably two-thirds of the interests involved in production in Southern California. The other one-third in production in other fields in California.

Q. In your appraisal work there did you value the oil royalties so far as the land owner interest was concerned?

A. Many landowner royalty interests.

Q. Have you ever bought and sold oil royalties yourself? A. Only in a minor way.

Q. Have you been employed by the banks and financial institutions to appraise oil royalties or oil properties? A. Yes, I have.

Q. To what extent?

(Testimony of John H. Wents, Jr.)

A. From time to time the banks, including the banks I mentioned, the Corn Exchange and Chase National Bank, have called upon me to voice my opinion with respect to the fair market value of various oil royalty interests which have appeared in the estates and what not, and in which the bank has acted upon.

Q. You speak of the Corn Exchange Bank and Chase National. They are in New York?

A. New York banks. Local banks would include the Bank of America, the Security-First National Bank, the California [100] Bank; probably most of them.

Q. What other experiences have you had in valuations?

A. When I finished Stanford University in 1927 I went to work for the Marland Oil Company in the valuation and research department, at which time I was directly under the employ of Carl Beal. I remained in that employ until 1929; during which time I worked on many valuation problems.

In 1929 I went to work for the Associated Oil Company in the petroleum engineering division. I was transferred to the geological department, and for four years was resident geologist and engineer in the central-coastal area, during which time I had occasion to appraise properties in the light of desirability of selling or purchasing for the account of the Associated Oil Company.

Q. Have you any further things you want to mention with respect to qualifications?

(Testimony of John H. Wents, Jr.)

A. I probably have missed a number of my employers in the past.

Q. Now, Mr. Wents, since 1939 have you been employed by the Dominguez Estate Company and the Carson Estate Company? A. Yes, I have.

Q. Tell the court just what your duties have been there with respect to them?

A. Dominguez Estate Company and the Carson Estate Company own some very important oil and gas lands here in [101] Southern California. They saw fit to employ me to look after their interests, they being the landowner. And in that instance in the course of that employment I have made careful observations and studies of the production of the wells which had been drilled upon the property previous to the date of my employment, those wells which have been drilled since the date of my employment, and all production to date of the individual wells of each of the leases. I have reported on various phases of reservoir performance. I have outlined to my employers at their request certain practices which should be called to the attention of the operating company, with respect to the future operation or the operation as of a date, of the properties, and in a general way just interpreted the leases and followed through and watched over the production and development.

Q. You are familiar with the production from the wells, are you, since 1938? A. I am.

Q. Including 1938? A. I am.

Q. And even prior?

(Testimony of John H. Wents, Jr.)

A. Oh, yes; from the inception of production on the individual wells.

Q. Now, will you please tell the court how many leases or where the land is located? I mean the Dominguez Estate [102] Company. Have you a map, Mr. Wents?

A. I have a number of maps. It takes three maps or four maps really to show the location of these lands.

Q. Could you get them on this board some way?

A. I could if I had some thumb tacks.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

By Mr. Mackay:

Q. Now, Mr. Wents, is that a map of the oil properties of the Dominguez Estate Company?

A. That is a map of the Dominguez oil field.

Q. Of the field?

A. Upon which are shown certain of the leases of the Dominguez Estate Company, as well as other leases.

Q. How many leases did Dominguez have on its lands?

A. There are 13 separate operators and properties involved.

Q. In other words, 13 separate leases?

A. There may be a couple more leases, because we have moved them in certain instances here (indicating).

Q. At least 13 separate leases?

(Testimony of John H. Wents, Jr.)

A. 13 separate, distinct properties, so far as we are concerned.

Q. Can you point those out to the court? [103]

A. With respect to those on Dominguez Hill I can. The Shell Company——

Q. Do you have a red pencil you can mark that?

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

By Mr. Mackay:

Q. Well now, Mr. Wents, referring to Joint Exhibit 17-Q, copy of which you have in your hand, and the court has and counsel has, will you explain to the court where the land of the Dominguez Estate Company is located?

A. The land of the Dominguez Estate Company upon Joint Exhibit 17-Q has been outlined in red. Land which is jointly owned or on a joint lessorship by Dominguez and Carson Estate Companies is shown cross-hatched in blue and red.

Q. Is that on the same exhibit? A. Yes.

Q. What do you mean by "cross-hatched"?

A. Cross-hatched, diagonal lines across the parcel.

Q. I see. That one large piece there in red, is that known as the Reyes lease?

A. The large central piece shown on the map is the Reyes lease.

Q. There is one there, the Tidewater Associated Oil [104] Company, DeFrancis lease. Is that owned by Dominguez lease?

(Testimony of John H. Wents, Jr.)

A. That is owned by the Dominguez Estate. We refer to it as the DeFrancis.

Q. The Shell-Manuel, is that the name of a lease?

A. The Shell-Manuel is owned by the Dominguez Estate Company.

Q. There are only three leases shown on this?

A. No. In the lower right-hand corner of the map is a lease we refer to as the Shelbar lease. That lease is a hundred-plus or minus acres.

To the left of that particular lease, in the lower part of the map, is the lease we refer to as United Oil Well Supply.

Q. Is that marked on there?

A. Only as a designation over the well.

The Court: It is only marked 46-plus acres; is that right?

The Witness: 46-plus acres is the size of that particular lease. Above the central or Reyes lease, up in the lower left-hand corner of a property marked as Carpenter, is a piece of property two acres in extent, in which the royalty is shared between the Dominguez and Carson Estate Companies.

By Mr. Mackay:

Q. On an equal basis? [105]

A. No, it is not upon an equal basis. One-ninth of the royalty is payable to the Dominguez Estate Company. One-eighth is payable to the Carson Estate Company.

Q. What other oil property has the Dominguez Company under lease?

A. On the map, designated as Joint Exhibit

(Testimony of John H. Wents, Jr.)

18-R—that is the next map in the series—there are five properties outlined in red. Commencing with the upper left-hand one, those leases are designated as the Wood-Callahan Oil Company. That property is owned by Dominguez Estate Company and the lease covers 140-plus or minus to that acres.

To the east of that, or left of that, is the lease we designate J. E. Pettijohn-Jergins Oil Company lease. That property is owned by Dominguez Estate Company and consists of 345 acres.

Then over still further to the east is a little property of eight-plus or minus acres, which is operated by the C.C.M.O. Oil Company.

Q. Who is the C.C.M.O.?

A. Chanslor-Canfield-Midway Oil Company.

Then moving across to the west again we have two properties over there. The Royal Petroleum Company lease, consisting of 114 acres, owned by Dominguez Estate Company, and the George F. Getty, Inc., 15 acres less.

Now, in reference to that latter property we [106] sometimes use the designation Standard-Getty lease because of the fact our royalty has been paid by the Standard Oil Company in the past.

Now, Joint Exhibit 19-S shows a single property, Dominguez Estate property, in the very central portion of the map area. That property consists of one city block, about 4.5 acres, and is operated by the Holly Development Company.

Now, Joint Exhibit 20-T. In this instance the Carson Estate Company and Dominguez Estate

(Testimony of John H. Wents, Jr.)

Company entered into a community lease for the development of approximately 300 acres of land; I mean as of this date. That 300 acres of land is shown on Joint Exhibit 20-T. The operator of the major portion of these lands is the Hilldon Oil Company. In the central portion of the Hilldon lease is a lease we designated here as the Victory Oil Company lease. They are the operators. The Dominguez and Carson Estate Companies are the landowners. The split between the two landowners is slightly in the favor of the Carson Estate Company by less than a half a per cent.

Q. Is that all the oil properties of the Dominguez Estate Company?

A. Yes, they are. They do happen to be shown on these maps. Also, the properties of the Carson Estate Company, but they are separately designated.

Q. Can you point out to the court what properties of [107] the Carson Estate are listed?

A. On Joint Exhibit 17-Q the property lying in the central left-hand portion of the map, Union Oil Company of California, Dominguez Oil Fields Company, Carson lease. That property of 349-plus or minus acres is owned by the Carson Estate Company.

As pointed out, the Carson Estate Company has an interest in the oil produced from the two acres of the Carpenter lease.

The Court: Are all these one-sixth interest royalties? Is that what they are?

(Testimony of John H. Wents, Jr.)

By Mr. Mackay:

Q. What are they, Mr. Wents?

A. Your Honor, they are various royalties. We will show in each case what the particular interest is. Generally one-sixth, unless otherwise noted.

Joint Exhibit 18-R, that is the second map of the series, and that would be in the central right-hand portion of the map where there is a small triangular piece of land outlined in blue, approximately five acres in extent, and referred to by us as the Standard-Carson lease.

Q. Is that on Joint Exhibit 18-R?

A. Yes.

Q. I see a three-cornered——

A. A little triangular section. [108]

Q. Section 13?

A. Yes. As explained with reference to Joint Exhibit 20-T——

The Court: You leave out 19-S because there is nothing on it?

The Witness: There is nothing on 19-S owned by the Carson Estate Company.

On Joint Exhibit 20-T I have explained the ownership of the lands there as being vested in both the Dominguez Estate Company and the Carson Estate Company.

The Court: That is all shown in the criss-cross red and blue marks?

The Witness: It is.

By Mr. Mackay:

Q. Mr. Wents, I will ask you if this is the lease

(Testimony of John H. Wents, Jr.)

of the amendments on the Reyes lease you speak about you identified to the court.

A. That is the original lease between the Union Oil Company and the Shell Oil Company with respect to the property we refer to as the Reyes lease.

Q. What is that other document you have in your hand?

A. That is an agreement.

Q. This, by the way, is dated 31st day of August, 1923?

A. Yes. That is an agreement which was entered into subsequent to that lease. [109]

Q. That is dated what date?

A. 1936, I believe; August 25, 1936. It is with respect to the Reyes lease.

Q. An amendment?

A. Really it is an amendment to the Reyes lease.

Mr. Mackay: I think these may both be offered as one exhibit.

Mr. Melville: No objection.

The Court: Just a moment. Let's complete these numbered exhibits first. You have used through 20-T; haven't you?

Mr. Mackay: For joint exhibits.

The Court: For joint exhibits.

Mr. Mackay: That is right.

The Court: It may simplify our numbering and help us if we arbitrarily start with Petitioners' Exhibit No. 21 for the next number, and let respondent start with AA for his first number of a separate exhibit.

Mr. Mackay: That is quite all right.

(Testimony of John H. Wents, Jr.)

Mr. Melville: Very well, your Honor.

The Court: We will mark the documents tendered as the Reyes lease as Petitioners' Exhibits 21 and 22, since there are two of them. They are fastened together. Mark them Petitioners' Exhibits 21 and 22. There being no objection, they will be received. [110]

(The leases referred to were marked and received in evidence as Petitioners' Exhibits 21 and 22.)

[Petitioners' Exhibits 21 and 22 set out in full in Book of Exhibits.]

Mr. Mackay: Could I indulge the court and take those tonight and get extra copies photostated to give to my opponent?

The Court: You may do so.

By Mr. Mackay:

Q. Now, Mr. Wents, I think you stated it was your duty to watch the production of the well since you went there and also to study the prior production? A. Yes.

Q. Can you tell what the average daily production was in 1938, 1939, 1940 and 1941, up to the basic date June 5, 1941?

A. I can refer to my records?

Q. Yes.

A. In order that the figures may be understood and may be weighed I have reduced it to royalty barrels in this instance. That gives——

Q. That is all we are interested in, is royalty barrels.

(Testimony of John H. Wents, Jr.)

A. I have started this in—what year do you want, 1930?

Q. 1938. [111]

A. 1938. In 1938 the total royalty barrels was 845,870 barrels to the Dominguez Estate Company.

The Court: Will you pardon the interruption? What does that mean? Does that mean estimated future production or the annual production for that year, or what?

The Witness: That is the annual production translated to royalty barrels from the property, all properties of the Dominguez Estate Company for the year 1938. In other words, in place of taking, say, a blanket one-sixth of the total gross production from all leases, this figure respects the different royalty rates had on the various leases.

The Court: Well, you gentlemen may understand what he means; I am not sure I do.

The Witness: That is the actual barrels of royalty oil.

The Court: That is the number of barrels that if oil had been divided in kind on the basis of, Dominguez Estate would have received that number of barrels?

The Witness: In barrels of oil.

The Court: I see.

The Witness: Yes.

The Court: All right.

Mr. Melville: Could we have that last question and answer, please?

(The record was read.) [112]

(Testimony of John H. Wents, Jr.)

The Witness: The year of 1939, 585,731 barrels.

The year of 1940, 520,448 barrels.

The five months of 1941, 229,159 barrels.

Mr. Mackay: I introduced the leases and amendment in the Reyes lease. I think it is agreeable to counsel that the other leases—we have a great many of them and we don't want to encumber the record—that the other leases are in substantially the same terms as this lease.

Mr. Melville: It may be so stipulated.

The Court: Very well.

By Mr. Mackay:

Q. Now, the Dominguez Estate Company didn't operate any wells; did it?

A. No, they did not.

Q. Approximately how much time have you devoted to Dominguez Estate properties since 1939, and particularly the time between 1939 and June 5, 1941? I will withdraw that.

A. Approximately half——

Q. I beg your pardon?

A. Approximately half my time, I would say, during that period of time.

Q. I see. How often would you visit the field, approximately? A. From three to——

Q. Every day, or every week, or what? [113]

A. From three to five times a week.

Q. From three to five times a week?

A. Yes.

Q. You have done that continuously since you were employed by them?

(Testimony of John H. Wents, Jr.)

A. During certain periods of time it might have dropped down to once or twice a week. Sometimes it has increased to twice a day.

Q. But, in any event, you were there at least several times a week?

A. Yes, I have been.

Q. That is, watching production and watching the wells, looking out for the interests of Dominguez Estate Company?

A. Yes, that is very true.

Q. And the Carson Estate Company?

A. And the Carson Estate Company.

Q. Have you made an appraisal of the oil royalty properties in the Dominguez Estate Company as of June 5, 1941?

A. I have.

Q. Tell the court what the basis has been for your examination and appraisal.

A. The appraisal I made of the oil royalties of the Dominguez Estate Company, as of June 5, 1941, was in the light of certain expected productions from each of the leases, which had been agreed by stipulation. [114]

Q. You are familiar with the stipulation?

A. Yes, I am familiar with it.

Q. You are familiar with the exhibits?

A. Yes, I am. In making this appraisal I followed, to a measure, the so-called analytical appraisal method, inasmuch as rates of production had been agreed upon by stipulation. Annual production for future years were translated to revenue; again on the basis of figures agreed to by stipulation.

(Testimony of John H. Wents, Jr.)

The Court: Let me see if I understand that. I am not trying to cross examine the witness, but I want to see if I understand it.

Mr. Mackay: It is quite all right.

The Court: You have agreed upon a projected estimate as to the production that might reasonably be expected from the different leases; is that what you mean?

Mr. Mackay: Yes, if your Honor please. We were confronted with this. We have agreed, as the stipulation shows, upon the oil reserves, estimated oil reserves at that basic date. And we have gone——

Mr. Melville: No. I believe that has been converted, Mr. Mackay, into probable future royalty income; hasn't it?

The Witness: No.

Mr. Mackay: Let's read the stipulation. [115]

The Court: I didn't mean to interrupt. I was trying to find out if I was following correctly.

Mr. Mackay: You are quite right. I am glad you did. I call your Honor's attention to page 5, paragraph (k) of the stipulation wherein it says:

“Joint Exhibit 11-K(1) is the estimated amount, in barrels of oil, of ultimate probable future production from known oil reserves of all oil properties owned by Dominguez Estate Company on June 5, 1941, together with the royalty share of the Dominguez Estate Company therein.”

And it goes ahead and explains what the estimated probable future production by calendar years is, and so forth.

(Testimony of John H. Wents, Jr.)

The Court: I see.

Mr. Mackay: That agrees upon the estimated oil reserves as therein stated.

“Joint Exhibit 11-K(2) is a computation, based upon said Joint Exhibit 11-K(1) and upon an agreed price per barrel of oil, said price being net revenue per barrels of royalty oil received from January 1 to May 31, [116] 1941. The estimated probable royalty income by calendar years is based upon the assumption that production will be in accord with the rates set forth in Joint Exhibit 11-K(1).”

The Court: That answers my question, I think. I am sorry if I disturbed you by interpolating the question.

The Witness: No.

The Court: You may proceed with your answer, Mr. Wents, if you can.

By Mr. Mackay:

Q. Do you want the reporter to read the last statement? A. Yes, it would help me.

(The answer was read.)

The Witness: Then, in accordance with the method of approach used, I translated annual revenues to the so-called present worth figures. Lastly, I translated present worth to fair market value.

By Mr. Mackay:

Q. Did you make an appraisal of the fair market value of each royalty interest? A. I did.

Q. Will you please state to the court what you

(Testimony of John H. Wents, Jr.)

mean by present worth? You say you made an analytical appraisal and reduced it to present worth. [117]

A. It has been my experience that future revenues or earnings must be translated to present worth before they can be translated to fair market value. Now, I base that entirely upon my experience in many years of dealing and appraising—I base that entirely upon my experience in dealing, buying and selling of oil royalties, and appraisal of oil properties.

Q. Now, what steps did you take to reduce that to present worth?

A. I translated annual incomes, expected annual incomes to present worth, by the use of a 10 per cent discount table or 120 per cent.

Q. Is that typically known as the Hoskhold's Formula?

A. Basically following the Hoskhold's Formula, taking into consideration in this case the income—half the income is had as of the central portion of the year.

Q. Referring to the Reyes lease, what was your present worth figure that you arrived at in your analytical appraisal?

A. The present worth figure which is an only indices of value, in my estimation, is \$4,172,321.00.

Mr. Melville: May I have that again, please?

The Witness: \$4,172,321.00.

By Mr. Mackay:

Q. Well now, after you determined, or after

(Testimony of John H. Wents, Jr.)

making a study of the stipulation and the exhibits, in the light of [118] the knowledge you had of the company and its operations, what did you do after you had computed what you call the present worth?

A. My next step was to reduce the present worth figures to the figure I call fair market value or appraised worth. The two terms being synonymous in this instance.

I have found that by using a discount, the discount being $43\frac{1}{3}$ per cent, with respect to present worth, I arrive at fair market value.

Q. $43\frac{1}{3}$, you say? A. $43\frac{1}{3}$.

Q. Yes.

A. However, I do it the opposite way by multiplying by $56\frac{2}{3}$.

Q. Why do you use that? Why do you discount present worth by that figure to get fair market value?

A. That figure was arrived at from a study of many, many transactions in royalties, landowner royalties and their equivalent of gross overriding royalty, one being basically the same as the other, trading with people who knew what they were trading in, where the sellers were completely familiar with what they were selling and the buyers were familiar with what they were buying, that figure happens to be the mean of the average trading. In other words, the figure which is meant on the street in trading of royalty [119] interests.

Q. You use that same method in valuing the oil

(Testimony of John H. Wents, Jr.)

properties for the government in its condemnation proceedings?

A. When oil royalties are involved, yes, I use exactly the same method.

Q. Will you please explain to the court how you arrived at 43-1/3 per cent?

A. The figure of 43-1/3 per cent was found to be the figure dictated by experience. In other words, in the buying and selling of royalties. The reason why buyers and sellers do not trade on present worth probably is—I should say reasons are manifold, are many.

Q. What are some of the reasons?

A. Likely one of the major reasons is that they are a little bit doubtful regarding the work of us engineers with respect to estimated ultimate production. Generally they are doubtful, with our estimate of rate of production, that is, annual rates of production or the timing of the production.

Then again a buyer wishes to receive more interest on his money and the seller generally has some place to put the money which would be more advantageous than holding it in the royalties.

The many things which would result in the application [120] of this discount and this amount would probably take a long, long time, and I couldn't think of all the reasons why or analyze the reasons why it is applied. It is my experience, my knowledge, it is applied.

The resultant answer after applying this, in this instance, to an appraisal which is figured on the

(Testimony of John H. Wents, Jr.)

basis of a 10 per cent discount factor, this discount only applies in the place of a 10 per cent discount factor, and would reduce that present worth figure, which has been had, to fair market value.

Q. Well, what, in your opinion, was the fair market value on June 5, 1941, of the Dominguez Oil Company interest in the Reyes lease?

A. In the Reyes lease?

Q. Yes.

A. The fair market value of the Dominguez Estate Company Reyes lease was \$2,364,329.00.

Q. Well now, what do you mean by fair market value, Mr. Wents?

A. The price which would be likely to be had from a trade between a willing buyer and a willing seller, both having full knowledge of conditions with respect to the property.

Q. Now, in your experience of valuing oil royalties, what was the name of that company? [121]

A. Diversified Royalties, Ltd.

Q. Had you followed the same method?

A. I followed it the last several years I was employed by them. It took me the greater part of two and a half years to figure it out, and the last two and half years I followed it.

Q. Now, Mr. Wents, referring to the DeFrancis lease, did you follow the same procedure there as you did in the Reyes lease? A. Exactly.

Q. Did you determine the present worth there?

A. Yes.

Q. What was your present worth figure?

(Testimony of John H. Wents, Jr.)

A. My present worth figure is \$192,068.00.

Q. What, in your opinion, was the fair market value on June 5, 1941, of the royalty interest of Francis Land Company in the DeFrancis lease?

A. That is the Dominguez Estate Company.

Q. That should be Dominguez Estate Company?

A. The fair market value of the Dominguez Estate Company, DeFrancis lease, is \$109,349.00 as of June 5, 1941.

The Court: May I ask a question?

Mr. Mackay: Yes.

The Court: Are figures contained in these exhibits that the witness is basing this upon? In other words, [122] do you have your stipulated projected or estimated figures of dollars?

Mr. Mackay: That is right.

The Court: That appears in one of these exhibits?

Mr. Mackay: Yes. That is in Exhibit 11-K(2), I think, your Honor. I will check and see. I think that is it. Your Honor please, -K(1) is the number of barrels.

The Court: Yes.

Mr. Mackay: And then, I think, -K(2) is the dollars.

The Court: I see. Now, you are really talking about what is shown, or he just finished on his two million-odd dollar figure, giving his estimate of the fair market value of the column that is shown there in your sub total of seven million-odd dollars under the Reyes lease?

(Testimony of John H. Wents, Jr.)

The Witness: Yes.

The Court: Now he has gone to the DeFrancis lease?

The Witness: Yes. In that instance, your Honor, we have not recited so far in this testimony the royalty dollars which might accrue in the ultimacy. We have just gone to present worth and appraised worth, is what we have done. Those figures having been derived, however, from the application of the discount factors to the figures which sum to this \$7,790,000.00——

The Court: In a general way what you do is you [123] take, for instance, in this DeFrancis lease, you take \$292,000.00 and you reduce that to present worth by 10 per cent discount formula?

The Witness: That is correct.

The Court: Which gives, you say, in the neighborhood of \$170,000.00?

The Witness: \$192,968.00 in that case.

The Court: Then you reduce?

The Witness: To fair market value.

The Court: By multiplying it by $56\frac{2}{3}$, or the same as reducing it $43\frac{1}{3}$ per cent?

The Witness: That is correct.

The Court: That give you what figure?

The Witness: \$109,349.00.

The Court: I see. Thank you.

By Mr. Mackay:

Q. Well now, turning to the Manuel lease for the Dominguez Estate Company, did you also go through the same process there with respect to

(Testimony of John H. Wents, Jr.)

determining present worth? A. I did.

Q. What was your figure for present worth?

A. \$53,582.00.

Q. Was that by using a 10 per cent discount factor? A. It was.

Q. Will you explain to the court just what that 10 per [124] cent discount factor is. in a general way?

A. A great many years ago a man by the name of——

The Court: I don't believe I care to have him explain it in any detail. I think I know a little about it.

Mr. Mackay: I will withdraw the question.

The Witness: I could give you the factors I used.

By Mr. Mackay:

Q. Never mind. I made a mistake. I think you have stated your present worth figure of \$53,582.00?

A. I did.

Q. What, in your opinion, was the fair market value of the royalty interest of the Dominguez Estate Company in the Manuel lease on June 5, 1941?

A. The fair market value of the royalty interest of the Dominguez Estate Company in the Manuel lease, as of June 5, 1941, was \$30,363.00.

Q. I think the next one is the Carpenter well.

A. Yes.

Q. What did you determine the present worth of that?

(Testimony of John H. Wents, Jr.)

A. The present worth of the Dominguez Estate Company interest in the Carpenter well as of June 5, 1941, was \$4,696.00.

Q. What was your opinion of the fair market value on that date?

A. The fair market value on that date was \$2,656.00. [125]

Q. Now, let's refer to the Selbar lease. Did you also work out your formula for determining present worth?

A. I followed the same procedure.

Q. What was the present worth figure?

A. The present worth of the Dominguez Estate Company interest in the Selbar lease as of June 5, 1941, was \$5,907.00.

Q. What, in your opinion, was the fair market value on that date?

A. The fair market value was \$3,383.00 as of June 5, 1941.

Mr. Melville: I didn't get the figure.

The Witness: \$3,383.00.

By Mr. Mackay:

Q. I call you attention to the United Supply well.

The Court: I wonder if we couldn't shorten it by taking all of the balance on that exhibit and ask him the question and let him give us the figures. Won't that shorten it?

Mr. Mackay: I think I can make it faster. I would like to have it, if I could, individually.

The Court: Very well.

(Testimony of John H. Wents, Jr.)

Mr. Mackay: I will speed this up.

The Court: I am not trying to hurry you.

Mr. Mackay: I understand, but it could be done.

The Court: Very well.

By Mr. Mackay:

Q. On the United Supply well, what was your present worth as of June 5, 1941?

A. \$2,896.00.

Q. What, in your opinion, was the fair market value?

A. The fair market value of the Dominguez Estate interest as of the same date was \$1,641.00.

Q. Will you just go ahead and give those figures, the present worth and the fair market value of the Standard-Getty lease, please?

A. The present worth, \$4,443.00. The appraised worth \$2,518.00.

Q. What do you say in respect to the Royal Petroleum lease?

A. The present worth, \$80,236.00. The appraised worth or fair market value, \$45,467.00.

Q. How about the C. C. M. O.?

A. The present worth in C. C. M. O. \$3,565.00. Fair market value, \$2,020.00.

Q. Holly Development venture?

A. Holly Development, the present worth \$25,-629.00. The fair market value \$14,523.00.

Q. The Hilldon-Caminol lease?

A. The present worth of the Dominguez Estate Company [127] interest is \$16,814.00. The appraised

(Testimony of John H. Wents, Jr.)

worth of the same interest, \$9,528.00. That is the fair market value.

Q. The Wood-Callahan lease?

A. The present worth \$86,626.00. The appraised worth or fair market value \$49,088.00.

Q. What about the Pettyjohn-Jergins-Lebow-McNee lease?

A. The Pettyjohn-Jergins-Lebow-McNee lease, the present worth \$117,346.00. The fair market value \$66,496.00.

Q. That is all of the Dominguez Estate Company; isn't it?

A. Yes, that covers the property.

Q. What is the total appraised value today for all of these? Have you added those up?

A. Yes.

Q. Can you give that, please?

A. The total fair market value of the interest of the Dominguez Estate Company as of the basic date was \$2,701,361.00.

Q. Now, with respect to the Carson Estate, I call your attention to Carpenter well one-third interest. Will you give the present worth and fair market value on that?

A. The interest of the Carson Estate Company in the Carpenter well has a present worth of \$1,638.00, and a fair market value of \$928.00.

Q. What about the Hilldon-Caminol lease of Carson Estate? [128]

A. The Carson Estate interest in the Hilldon-

(Testimony of John H. Wents, Jr.)

Caminol lease has a present worth of \$17,042.00 and a fair market value of \$9,657.00.

Q. What about the Union-Carson lease of the Carson Estate Company?

A. The Union-Carson lease, which is owned completely by the Carson Estate Company, has a present worth of \$287,883.00, and a fair market value of \$163,135.00.

Q. Standard-Carson lease?

A. The Standard-Carson lease has a present worth of \$782.00 and a fair market value of \$443.00.

Q. What is your total for the Carson Estate Company fair market value?

A. It is \$174,163.00.

Mr. Mackay: If your Honor please, I think that I would like to recess, please, for a short time.

The Court: Very well.

Mr. Mackay: I think the reporter needs a rest.

The Court: I think she does, too.

(Short recess taken.)

By Mr. Mackay:

Q. Mr. Wents, have you the average daily production in 1938 and 1939, 1940 and up to the first five months of 1941?

A. In royalty barrels do you mean? [129]

Q. Yes. A. Yes, I have.

Q. Of the total properties of the Dominguez Estate Company? A. Yes, I have.

Q. What are they?

A. The daily royalty barrels for the Dominguez

(Testimony of John H. Wents, Jr.)

Estate Company for the years 1938, 1939, 1940 and the five months of 1941 are as follows:—

The Court: Now, are these figures in the exhibit we have?

Mr. Mackay: No, they are not.

The Court: It is rather difficult to read them into the record accurately and get them accurate, and we have to make up a table. Wherever it is convenient I would like to have, instead of the witness reading them into the record, his schedule introduced as an exhibit.

I am not telling you to do that in every instance.

Mr. Mackay: We will do that. We will submit one tomorrow.

The Witness: If I can prepare one from the sheets here, why, yes.

Mr. Mackay: Can you prepare one tonight and bring it in the morning?

The Court: It is much easier to work on and we [130] are more apt to be accurate.

Mr. Mackay: Mr. Wents, can you work that up tonight and have it here in the morning for us?

The Witness: Yes.

Mr. Mackay: I think that is all.

Mr. Melville: May I ask your Honor what time the court may adjourn for the evening?

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

You may proceed.

(Testimony of John H. Wents, Jr.)

Cross Examination

By Mr. Melville:

Q. Mr. Wents, do you have with you the price of oil per barrel which you used in converting the barrels of oil into estimated future royalty income for each lease?

A. Yes, I can read those off.

Q. Could you prepare a chart, in line with what his Honor has indicated he would like to have—off the record.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

By Mr. Melville:

Q. In your direct examination, Mr. Wents, you referred to many, many royalty transactions which formed the basis of [131] your arriving at the figure of 43-1/3 per cent? A. Yes.

Q. Do you have the details as to those many, many royalty transactions?

A. I have in my files, I believe, considerable records.

Q. Would you bring them to court tomorrow, please?

A. If I can't get them tomorrow I will have them here the next day. It depends on how much I can go through the files. I will try my best to have them ready for you.

Q. Do you know offhand how many of those transactions you used in arriving at the figure of

(Testimony of John H. Wents, Jr.)

43-1/3 per cent? A. No, I don't offhand.

Q. Well, those are the ones that we would be interested in; if you would bring those please, it would be appreciated.

The Court: Very well, we will suspend at this time until 10:00 o'clock tomorrow morning.

(Whereupon, at 4:50 o'clock p.m., a recess was taken until 10:00 o'clock a.m., Tuesday, October 9, 1945.) [132]

[Title of Tax Court and Causes.]

PROCEEDINGS

October 9, 1945, 10:15 a.m.

The Clerk: Docket No. 2257, Victoria L. Cotton. Whereupon,

JOHN H. WENTS, JR.

resumed his testimony as follows:

Direct Examination (resumed)

By Mr. Mackay:

Q. Mr. Wents, you were requested last night to prepare——

Mr. Melville: Are you going to resume direct?

Mr. Mackay: Yes. I had him prepare a statement of the daily production.

Mr. Melville: I just want to keep the record straight, because the cross examination had started.

Mr. Mackay: Had you started?

Mr. Melville: Yes.

(Testimony of John H. Wents, Jr.)

The Court: Do you wish to examine him further upon——

Mr. Melville: I have no objection. I want to make the record clear on that point.

Mr. Mackay: I think it would be a little better if I clear this point up, if it is agreeable with you.

Mr. Melville: No objection.

The Court: Very well.

By Mr. Mackay:

Q. You were requested yesterday, Mr. Wents, to prepare a table of production from each lease showing the average [137] daily production for the years 1938, 1939, 1940, and the five months of 1941.

A. Yes.

Q. Have you done so? A. Yes.

Q. Is this it here (indicating)?

A. Yes. I had better put them in order. I have done it for both the Carson Estate properties and the Dominguez Estate properties, as requested. There are five properties. That is the Dominguez Estate (indicating).

Mr. Mackay: Your Honor please, I should like to offer this in evidence.

The Court: Is there objection to the receipt of this document?

Mr. Melville: No objection.

The Court: It may be received in evidence as Petitioner's Exhibit No. 23.

(The document referred to was marked and received in evidence as Petitioner's Exhibit No. 23.)

(Testimony of John H. Wents, Jr.)

By Mr. Mackay:

Q. Have you a similar one for Carson?

A. Yes, I have, but in typing this it has been noted the daily average should be down here (indicating). The double lined numerals are the daily average royalty barrels.

Q. You mean the last figure on this one should be the [138] daily average (indicating)?

A. Yes. It so happens that the number of days is the multiple I divided the yearly production by.

Q. You mean the daily average should be below the days?

A. That is correct.

Mr. Mackay: If your Honor please, I should like to offer this in evidence.

The Court: Very well. This document entitled "Royalty Barrels By Year, Carson Estate Company" may be marked and received in evidence as Petitioner's Exhibit No. 24.

(The document referred to was marked and received in evidence as Petitioner's Exhibit No. 24.)

By Mr. Mackay:

Q. Now, Mr. Wents, you gave your opinion as to the fair market value of the various oil properties here yesterday. Did you check that opinion with other indices you are familiar with?

A. Yes, I did.

Q. Will you please explain to the Court about that?

A. There are a number of ways of checking an estimate of fair market value against the yard-

(Testimony of John H. Wents, Jr.)

sticks which are used by the man on the street, by some oil operators. Among these yardsticks are the measurements of the value of oil in the ground, royalty barrels of oil in the ground. Another yardstick is the price paid per daily barrel. A third one is the [139] pay-out, monthly pay-out.

In the use of these yardsticks there it is common to use the production for a period of time, say, one month to six months prior to the valuation day.

Now, in my checking I found that with respect to the Reyes lease, which is the major unit of value of the oil in the ground, that is, 6,333,333 barrels of royalty oil which I appraised as having a fair market value of \$2,364,329.00, was equivalent of 37-1/3 cents per barrel in the ground.

Then based upon the average of the five months of 1941, previous to our valuation date, the royalty barrels per day average we divided into my figure of fair market value and it gives a worth of \$1,805.00 for daily royalty barrel.

With respect to pay-out, the average royalty barrel for the five months previous to June 5, 1941, would have to be produced continuously for 49 months in order to pay out, in accordance with my appraised worth figure.

Now, with respect to the totals, approximately the same relation shows. Now, based upon a total for both the Dominguez Estate Company and Carson Estate Company, the oil in the ground is figured at 34 1/4 cents a barrel. The daily royalty barrel rate is \$1,894.00 per daily royalty barrel. I believe

(Testimony of John H. Wents, Jr.)

those figures are fair figures in the light of what is common in royalty trading.

Mr. Mackay: You may take the witness. [140]

Cross Examination

By Mr. Melville:

Q. Mr. Wents, yesterday you were asked to prepare a chart showing the price per barrel of oil you used in arriving at your estimate. Do you have that prepared?

A. Yes, I have. Mr. Melville, these were the prices I not only used, but the prices which were agreed upon in the stipulation.

Q. That is my understanding. A. Yes.

Q. This is for Dominguez; this is for Carson?

A. Yes, these are the names of the leases and the figure to the right is the price per barrel.

Mr. Melville: Your Honor, in an attempt to dispose of as many of the facts in this case by stipulation as possible, extensive conferences were held between both parties, and we tried to agree upon the fair market value of these oil royalties. Failing in that, we went back to the factors which must be considered in arriving at the fair market value of the oil royalties, to see if we could not agree upon those. Those factors are first, the number of barrels in the ground; second, the rate of exhaustion, how fast is it anticipated it might come out; third, the price which it is reasonable to assume will be received for the barrel of oil after it comes out of the ground at some future date. [141]

(Testimony of John H. Wents, Jr.)

We did agree on all those factors and reduced them to net royalty income for the years from 1941 through 1965.

Now, subsequent to preparing that exhibit, which is in evidence, other exhibits have been prepared to go back and show the factors which made up that exhibit, namely, the oil in the ground; and two, the rate of exhaustion. I am simply completing the picture now by offering in evidence a page which shows the price per barrel which was used by both parties in arriving at the factors which have gone into the exhibit which shows probable future royalty income.

I offer at this time as Respondent's Exhibit AA, I believe, the report prepared by Mr. Wents setting forth the agreed price per barrel which was used in connection with the other exhibits which are in evidence.

The Court: Is there objection to the document?

Mr. Mackay: No. If your Honor please, I may state we have stipulated that and it is just a question of working out the mathematics. I certainly have no objection to that.

The Court: It will be received as Respondent's Exhibit AA.

(The document referred to was marked and received in evidence as Respondent's Exhibit AA.)

[Respondent's Exhibit AA set out in full in Book of Exhibits.]

(Testimony of John H. Wents, Jr.)

By Mr. Melville:

Q. Mr. Wents, you testified yesterday that you had recently appeared as a witness before the United States District [142] Court in a valuation proceeding. Is that correct?

A. I testified I had appeared and one of the cases was recent.

Q. Recently.

A. I did not say that yesterday, but one of the cases had been recent.

Q. I understood you to say you had been recently a witness for the government?

A. That is true, yes.

Q. Was that a case before the United States District Court? A. Yes.

Q. Did you testify in that case as to a value of around \$10,000.00?

A. Yes, I believe so.

Q. Did the jury find the value of around \$20,000.00, or twice your figure?

A. The jury found a value which was composed of two units, which was around \$20,000.00, I believe.

Q. I believe you also said yesterday that you had had experience in valuing oil properties in the light of selling and in the light of purchasing?

A. Yes.

Q. Did you value them differently?

A. No. [143]

Q. If you were valuing oil properties for a prospective purchaser, you would value it in the same way that you would value it if you were

(Testimony of John H. Wents, Jr.)

valuing it for a prospective seller?

A. I would furnish the prospective purchaser and/or the prospective seller with my idea of the fair market value of the royalty upon which I had been requested to make an appraisal.

Q. Would you use the method you have used in this case? A. Yes.

Q. Then you would arrive at the same value whether you were furnishing it to the prospective buyer or to the prospective seller?

A. Yes, I would.

Q. You testified that you had valued oil royalties for Diversified Royalties, Ltd?

A. I did.

Q. Do you have any opinion as to—has the Diversified Royalties gone into bankruptcy?

A. The Diversified Royalties did go into bankruptcy.

Q. Was that due, in your opinion, to the fact you valued the oil royalties for the purchaser, by Diversified Royalties, in the same formula you valued it for the sale of Diversified Royalties?

A. I did not value for the sale of Diversified Royalties.

Q. Your testimony is you made no valuation for Diversified Royalties with respect to sales? [144]

A. I made certain exhibits for Diversified Royalties, not appraisals. I prepared certain exhibits. The Diversified Royalties appraisals were prepared by outside engineers; that is, with respect to the selling.

(Testimony of John H. Wents, Jr.)

Q. With respect to the buying?

A. With respect to the buying, I prepared the appraisals with respect to the buying; that is, in a great number of instances. Sometimes my work was checked by the employment of another appraiser.

Q. What connection did your father have with Diversified Royalties?

A. My father was vice-president of Diversified Royalties, I believe.

Q. What was your connection?

A. I was an employee of Diversified Royalties for a time. I held a nominal title of vice-president. I never had any voting capacity.

Q. Did you sell royalties to Diversified Royalties? A. No.

Q. Did your father?

A. Not that I know of; he may have. I was with Diversified Royalties a much shorter time than my father was with them.

Q. Did the Securities and Exchange Commission ever conduct an investigation into Diversified Royalties? [145]

A. The Securities and Exchange Commission?

Q. That is right.

A. Not that I know of.

Q. Did the Corporation Commission of California ever conduct an investigation into the operation of the Diversified Royalties?

A. Yes, it did.

Q. Do you have with you or available any copies

(Testimony of John H. Wents, Jr.)

of appraisals that you made and submitted to Diversified Royalties? A. No, I do not.

Q. You couldn't obtain them, even by tomorrow?

A. I obtained from my files certain of the information requested of me yesterday; that I had compiled. However, with respect to the appraisals made for Diversified Royalties, I am not sure whether I have any of that material in my files or not, excepting in very sketchy form.

Q. Yesterday you read into the record the figures from 1938 to 1940, inclusive, and for the five months of 1941 as to the oil royalties of Dominguez Estate Company, and it showed it declined from 845,870 barrels in 1938, and so forth. Do you have those figures?

A. Those are the figures I had copied, and were furnished to you.

Q. Do you have them in front of you?

A. Yes, I have them. [146]

Mr. Mackay: It is in this exhibit (indicating).

Mr. Melville: It was just as much in evidence yesterday, too.

Mr. Mackay: I am sorry. I was just trying to be helpful.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

By Mr. Melville:

Q. Now, Mr. Wents, in going back to 1938 and reading forward to 1940 and the first five months of 1941, it showed a declining rate; didn't it?

(Testimony of John H. Wents, Jr.)

A. These figures disclosed a declining rate, yes.

Q. If you go back to 1927, what does it show?

A. My figures do not go back to 1927. They go back to 1930.

Q. They go back to 1930. What was the figure, corresponding figure?

A. The total royalty barrels produced from Dominguez Estate leases for the year 1930 was 383,756.

Q. Do those figures, from the years 1930 to 1938, show a gradual increase in production?

A. They show a gradual increase to the year of 1938, yes.

Q. That is what I wanted to bring out. Now, Mr. Wents, does the federal government by any rulings or regulations [147] curtail the production of oil?

A. The federal government does not curtail the production of oil in California.

Q. Does the State of California curtail the production of oil or have they curtailed the production of oil in the State of California?

A. The State of California does not curtail the production of oil in California.

Q. Does anybody curtail the production of oil in California, Mr. Wents?

A. Yes, a conservation committee curtails the production of oil in California.

Q. All right. Does that curtailment of production of oil have any direct bearing on the facts that

(Testimony of John H. Wents, Jr.)

there has been a decrease from 1938 to 1941 in the amount of oil produced?

A. It has some bearing, yes.

Q. Thank you. You went into considerable detail yesterday in valuing each of the leases of the Dominguez Estate Company and of the Carson Estate Company?

A. I did.

Q. Do I understand your testimony to be in each case you used, first, a 10 per cent discount factor, and second, a $43\frac{1}{3}$ discount factor?

A. I did.

Q. Are you familiar with a term used in the oil industry [148] as a "blue chip" property or a "blue chip" lease?

A. No, I am not.

Q. Do you consider all of these leases to be of equal value?

A. No, I do not.

Q. Which lease do you consider to be best?

A. The Reyes lease.

Q. And of the total amount of oil in reserve in all leases, does the Reyes lease represent something, about 90 per cent of the total?

A. The relationship between $6\frac{1}{3}$ million and $8\frac{4}{10}$ million would express it.

Q. Do you have a slide rule?

A. No, I have not, with me.

Q. Which would you say was the least desirable lease?

A. I would say probably, if any of the leases were in question regarding desirability, the unexplored areas of the Torrance lands would have the most.

(Testimony of John H. Wents, Jr.)

Q. But you did value all of the leases by using exactly the same discount factors for the Reyes lease, which comprises substantially all of the oil reserves right straight through, including all of the leases which are of less desirability?

A. Yes. However, in the use of that factor those things are weighed out and the answer comes out much differently in the end. For example, the oil in the ground in the Reyes lease [149] is valued at approximately 40 cents a barrel. The oil in the ground on the Torrance leases is only valued at 14 cents a barrel.

Q. And you feel that that difference justifies using the same formula for each lease?

A. Why, the answer, the justification of the use of the formula—because different answers are had—the formula is just a means of arriving at the value. The values will not be one—you couldn't put a blue chip against a brown chip, if you want to use those terms, or a sound royalty against a speculative royalty by using the approach I used.

Q. And is this same method of valuing by discounting 10 per cent and then $43\frac{1}{3}$ per cent, is that the method you used in valuing royalties for Diversified Royalties?

A. Yes, it is.

Q. Under the leases involved, did the lessors have the right to receive the oil in kind at their option?

A. Yes, depending upon the exercise within certain periods of time.

(Testimony of John H. Wents, Jr.)

Q. It was within their option to take the oil in kind if they wanted it?

A. That is correct.

Q. And prior to 1940 the fee owner had, from time to time, taken royalty in kind; had it not?

A. From certain properties. Not from oil properties at all times. [140]

Q. When they did so, they sold it to purchasers for bonus prices of more than 20 cents per barrel above the posted price of oil which the lessee was required to pay; is that correct?

A. I believe the Socal contract was based on about that.

The Court: What contract?

The Witness: Socal, the name of a refining company.

The Court: Some of these terms are unfamiliar to the reporter.

The Witness: S-o-c-a-l.

By Mr. Melville:

Q. Was about at that figure?

A. I am not sure.

Q. Wouldn't you say that each time the lessors chose or elected to take oil royalty in kind it was for a price advantage?

A. No, I would not.

Q. What other purpose would there be to take oil in kind, rather than the royalties at the posted price?

A. May I explain that the Dominguez Estate Company has taken the oil in kind from the Reyes lease for many years. The Shell Oil Company is

(Testimony of John H. Wents, Jr.)

the operator of the property by letter agreement between the Dominguez Estate Company and the Union [151] Oil Company. The Union Oil Company takes the Reyes oil, the royalty share of the Reyes oil, and pays it at the same price as posted by the Union Oil Company and adopted by the Shell Company in the field.

Q. That is as to the Reyes lease?

A. The Reyes lease.

Q. Wasn't the oil from the Reyes lease ever sold at a bonus above the posted price?

A. That question was answered. Yes.

Q. Now, the oil prices that you used in your valuations do not include any possible future bonuses in excess of the oil, posted oil prices; do they?

A. No, they do not.

Q. You said yesterday that you discounted probable future royalties to present worth by using the Hoskhold's Formula, and you started to tell the Court about that formula but were interrupted, I believe, after saying, "A long time ago a man named——"

A. That is right.

Q. Your introductory remarks started like a fairy tale. I would like to hear the rest of it.

A. The Hoskhold's Formula is a formula upon which the present value of a dollar returnable—is payable some years hence, one year or a fraction or a year or many years hence, at a certain rate of discount. It is calculated, in other [152] words, a dollar which is coming to you six months hence at the rate of 10 per cent is equivalent to 95 and

(Testimony of John H. Wents, Jr.)

a fraction cents in your pocket today. It goes on down the list. A dollar which is due two years hence is worth 86 and a fraction cents.

Now, the formula or the table used is just an adoption of the Hoskhold's Formula, based upon the factor and recognizing the fact that royalty incomes are received monthly. And it compensates for that because the dollar does not come to you at the end of a specific period of time, but comes to you during a period of time.

Q. Does the Hoskhold's Formula use one discount factor or two?

A. The Hoskhold's Formula on the 10 per cent table is one discount factor, as I used. Maybe in certain cases the Hoskhold's Formula involves two discounts.

Q. I know. You said yesterday that you didn't have a degree in engineering. Don't you know that a formula is something definite rather than something variable?

A. The formula that I used—I can recite the formula I use.

Q. We are talking about the Hoskhold's Formula. Does it contain more than one discount factor?

A. I am not sure. I did not derive the tables. I use the tables, but I did not derive the tables.

Q. Do you have a copy of Hoskhold's book entitled "Engineers' Valuing Assistant"?

A. No, I do not.

Q. Have you ever read it?

(Testimony of John H. Wents, Jr.)

A. I have read parts of it.

Q. Why didn't you read it all?

A. Because I wasn't interested in it all.

Q. Are you following the Hoskhold's Formula?

A. No, I am following an adaptation of the Hoskhold's Formula, derived by Dr. Burt of the Shell Company.

Q. Where did you get your information regarding the Hoskhold's Formula?

A. I suppose I was first introduced to it in Brown's "Valuation of Oil Lands."

Q. Do you know who Hoskhold was?

A. He was an Englishman, I believe.

Q. What period of time did he live?

A. In the early 1800's, I believe.

Q. Does the Hoskhold Formula contain a sinking fund factor?

A. Certain of the Hoskhold Formulas contain sinking fund factors.

Q. You mean there is more than one Hoskhold Formula?

A. There are different uses of the Hoskhold Formula, according to the Hoskhold textbook, and according to the uses— [154] I mean the reprints of portions of the Hoskhold's text you have a series of inter-rates, inter-tables worked out whereby the present values can be read, directly read, based upon—or the present value factor can be read direct. Certain of those tables embody sinking funds; certain of them do not.

Q. Is it your testimony now there is more than

(Testimony of John H. Wents, Jr.)

one Hoskhold's Formula, or only one and various applications of it?

A. There is probably one and various applications; I am not sure.

Q. Don't you know? A. No, I do not.

Q. You do not know whether there is more than one Hoskhold's Formula?

A. I am of the opinion there is more than one Hoskhold's Formula, each for a different purpose. It may be that my opinion is wrong and there are only variations.

Q. That being the case, when you decided to use the Hoskhold's Formula, how did you select the one you wanted to use?

A. I used the 10 per cent factor consistently in all of my appraisals, for the simple reason that the answer that I get from that is only a part of my ultimate answer. It is not the answer to the problem; it is a part.

My professors in college dwelt upon that a lot. I probably followed their lead in the using of the factors. They [155] might have perhaps differed in the choice of 6 per cent, 7 per cent, 8 per cent, 9 per cent, or 10 per cent. Or they might have referred to sinking funds in them. I chose, for my purposes, the 10 per cent table and I use that exclusively because then I can reduce it to my figure of fair market value. If there is any other table used by a different appraiser for my purposes, I translate it to 10 per cent.

(Testimony of John H. Wents, Jr.)

Q. Is it your opinion that 10 per cent is a reasonable rate of interest?

A. I do not use the 10 per cent table to reflect a rate of interest or money worth.

Q. Does the Hoskhold's Formula provide for retirement of capital prior to the termination of the investment period?

Mr. Mackay: Well, if your Honor please, I don't—

The Witness: That is a sinking fund.

Mr. Mackay: It seems to me his cross-examination is improper. We didn't go into the Hoskhold's Formula yesterday.

The Court: Well, I stopped him from going into it. I thought I knew something about what he meant by the Hoskhold's Formula; I am not sure I do. We will let him proceed with the cross-examination.

Mr. Melville: I am proceeding on the theory the witness doesn't, either.

Mr. Mackay: We will keep on; you will find out. [156]

By Mr. Melville:

Q. Did you answer the question?

The Witness: Will you repeat the question?

(The record was read.)

The Witness: There are certain tables provided in Hoskhold's book which provide for retirement of principal, as well as interest.

By Mr. Melville:

Q. Isn't it a fact that the Hoskhold's Formula

(Testimony of John H. Wents, Jr.)

has two rates of interest, one a speculative rate on the investment, and another, a safe rate on the sinking fund? A. Perhaps then I have——

Q. You can answer that yes or no.

A. I am not sure.

Q. Does the Hoskhold's Formula apply only to the valuation of equal annual income throughout the investment period?

A. I think in certain instances the tables are worked out on the basis of equal annual income; but other instances they are not.

Q. You mean the formula would be the same formula and would be applicable to a situation——

A. I said there were probably more than one formulae.

Q. Let's talk about the one you know about. Does that formula apply as well to a situation where you have equal annual income as it does to one where you have diminishing annual income?

A. The one I use applies the same.

Q. Does the Hoskhold's Formula apply equally to the situation where you have constant annual income, as well as to the situation where you have diminishing annual income?

A. The Hoskhold's, I believe, applies to constant.

Q. And does not apply to a situation where you have diminishing annual income?

A. I am not sure, but I would say no.

Q. Could you explain just how you modify the Hoskhold's Formula in order to apply it in this

(Testimony of John H. Wents, Jr.)

case for valuing equal annual income—pardon me—to apply it in this case for valuing unequal annual income?

A. In this case the table or the factors that are used takes into consideration that the income of all royalties is payable, or the income is payable monthly, and that the income had during the first period of the year will be slightly greater than that had during the second period of the year.

Q. Then it is your testimony, as I understand it, that you did not use the Hoskhold's Formula?

A. I used a formula derived by Dr. Burt of the Shell Company, a formula which I was taught was more adaptable for the purposes of oil valuation than the true Hoskhold's Formula.

Q. What is his name? A. Dr. Burt. [158]

Q. Take the Reyes lease, Mr. Wents, what was its 1941 probable oil income after June 5, 1941?

A. Based upon the estimate which was made a part of the stipulation?

Q. That is right.

A. The seven months remaining in 1941?

Q. That is right. A. \$368,645.00.

Q. What was the discount factor which you used in discounting that to present worth?

A. .9535.

Q. Then you took off another 43 1/3 per cent to get what you called fair market value?

A. From the sum of the present worth accruing for each of the years—that is, accruing from the income for each of the years from 1941.

(Testimony of John H. Wents, Jr.)

Q. I don't believe that is responsive to the question, Mr. Wents?

A. In the ultimate I took off $43\frac{1}{3}$ per cent at the end. I didn't do it by years.

Q. If you didn't take it off in the first year, I take it, you didn't take it off until the very end?

A. I took it off of the sum of the present worth.

Q. At the very end, 1965?

A. When I assumed my present worth, which is past 1965, [159] the answer I got there at that point, which was \$4,172,321.00, was discounted by $43\frac{1}{3}$ per cent; the answer being my opinion of the fair market value of the property, or \$2,364,329.00.

Q. As I understand your testimony, then, you didn't apply that discount factor of $43\frac{1}{3}$ per cent to any particular year, but to the grand total?

A. It is applied probably indirectly to each particular year. I applied it to the grand total.

Q. But to no particular year?

A. No particular year.

Q. Does the Burt Formula, which you said you used, provide for applying the formula for each particular year or to anticipate for 20 years in the future and apply it at the end?

A. No, the formula for each particular year.

Q. So that you didn't follow the Burt Formula either? A. I did.

Q. But you didn't apply your factors to each particular year; did you? A. Yes, I did.

Q. You say you did, now?

(Testimony of John H. Wents, Jr.)

A. Yes. I didn't apply my $43\frac{1}{3}$ per cent to each individual year; that was your other question. The Burt factors were applied to each individual year.

Q. That clears that up. Mr. Wents, if you didn't take that $43\frac{1}{3}$ per cent out of the first year's income, what year [160] did you take it out of?

A. I didn't take it out of any specific year. I took it out of the total.

Q. Then would that be taking it out pro rata for each year?

A. It would have the effect of taking it out pro rata for each year.

Q. Now, coming back to the first year, applying that then back to the first year, how many cents on the dollar was one barrel of oil worth, according to your appraised value?

A. To the first year?

Q. Yes. A. I would have to figure it out.

Q. Would you do so now, hurriedly? Would you be surprised if I told you it was 54 cents on the dollar?

A. It might be well to explain that the discount there of $43\frac{1}{3}$ per cent anticipates the life of the property, which is extremely longer than a year. I would not deny the first year's income was worth more than the second year's. I would also say the second year's income would be worth more than the third. However, over a period of 25 years, with the various things that might be happening in that

(Testimony of John H. Wents, Jr.)

period of time, then the composite of $43\frac{1}{3}$ is applicable.

Q. Now, $43\frac{1}{3}$ then is derived, recognizing it is to apply over a period of years? [161]

A. Over a period of years.

Q. How long a period of years?

A. I have used it indiscriminately between 20 and 30 years. If my income is coming to me faster than that, I change it.

Q. Take your total valuation of \$2,701,000.00 for all the probably future royalties in all the developed royalties reserves of Dominguez Company——

A. \$2,701,361.00.

Q. ——what percentage rate of interest would an investor receive over and above income taxes on a return of his investment if he could buy those royalties at the value you have placed on them?

A. Will you repeat that question?

Mr. Melville: Yes.

(The question was read.)

The Witness: I do not know.

By Mr. Melville:

Q. If I should tell you that the rate of return would be 18 per cent compound interest for more than 25 years, would you be surprised?

A. I would be muchly surprised.

Q. If we can establish that that is the correct percentage, would you be willing to change your opinion as to the valuation? [162] A. No.

Q. Then what leads you to believe that such a

(Testimony of John H. Wents, Jr.)

rate of interest is justified for such a high-class oil royalty as we are dealing with here?

A. There is an assumption made there that is not logical. Providing that a guarantee might be had that the yearly rates of production and the incomes, as we have figured them here, would be had without failure, then my answer is wrong. But providing there might be, there is any number of things that might affect the production, the future production.

Q. Are you getting away from the stipulation?

A. Getting away from the stipulation?

Q. Yes.

A. We did not stipulate to value in the stipulation.

Q. We have stipulated the probable future royalty income.

A. That is an estimate I used as a guide in arriving at my figure of value.

Q. Using the stipulated figures as to probable future royalty income, if it were established to your satisfaction that that works out, working it backwards, to a percentage of 18 per cent compound interest, would you consider that to be a fair rate for oil royalties such as the Dominguez Oil Field?

A. As you last state it, I think your answer may be right. [163]

The Court: What do you mean by that? I don't understand your answer.

The Witness: He changed the wording of his statement there. And assuming that it could be a

(Testimony of John H. Wents, Jr.)

guarantee these things would happen, then his answer may be correct?

The Court: His answer?

The Witness: Or his statement. He made a statement. His statement may be correct.

The Court: Very well. You may proceed.

By Mr. Melville:

Q. What value did you attribute to the royalties from the Reyes lease of 1965?

A. The present worth after 1965 of the income is \$19,848.00.

Q. Did you apply your other factor of 43 1/3 per cent to that?

A. Not specifically to that figure.

Q. Why not?

A. I applied it to the aggregate of all the figures, and that figures a part of the total.

Q. Exhibit 11-K(2) has a subtotal of \$7,459,745.00, and a total of \$7,790,000.00. Which of those did you apply your factors to?

Mr. Mackay: What factors are you talking about?

Mr. Melville: 10 per cent and 43 1/3 per cent.

Mr. Mackay: If your Honor please, I don't think we are trying to put a value in 1965 upon anything. We are trying to confine our values to June 5, 1941. The witness has not testified yet as to the fair market value in 1965 of any particular properties. It is not in issue, it is not proper cross-examination.

It is true, so far as our estimated oil reserves and

(Testimony of John H. Wents, Jr.)

the probable rate they should come out of the ground, have been stipulated. Certainly, we haven't gone into the fair market value in 1965, and there is no testimony along that line.

The Court: If I understand the witness correctly, he applies his 10 per cent factor on each of the years.

The Witness: That is correct.

The Court: And then after he did that, he added all those up and applied the 43-1/3 per cent factor.

The Witness: Yes, I think that is right, your Honor. That is correct.

Mr. Mackay: And in doing that, to arrive at what he called present worth. Now, we are getting down here to determining fair market value, and that applies only to fair market value on June 5, 1941, not 25 years from now.

Mr. Melville: My questioning was directed to ascertaining what, in the opinion of this witness, the 1941 value is or was of the future royalty income stipulated as [165] probable on Exhibit 11-K(2); the 1941 value of the right to receive subsequent to 1965 the royalty income stipulated.

By Mr. Melville:

Q. Is the question clear?

The Court: Do you understand the question, Mr. Wents?

The Witness: Yes, I do.

The Court: You may answer it, please.

The Witness: The answer would be 56 2/3 per cent of \$19,848.00.

(Testimony of John H. Wents, Jr.)

The Court: Where do you get the \$19,848.00?

The Witness: There is 1,611,000 barrels of oil, which will be produced, in accordance with the stipulation, after the year of 1965. The royalty share on that number of barrels of oil is \$268,500.00. The price agreed upon for the oil throughout that period was \$1.23, which gives \$330,255.00 of expected income to be had after 1965.

By Mr. Melville:

Q. What was that figure again?

A. \$330,255.00. The discount factor I applied to that, to compensate for its deferment, was .0601, which is about the discount for approximately the 30th year.

The present worth of that income, that is, what it would be worth in accordance with those discount tables is \$19,848.00. And as far as appraised worth is concerned, following [166] my system, I might analyze that figure and say it is worth probably 56 2/3 per cent of it.

Q. Now, Mr. Wents, would you advise your employers to sell, or would you have advised your employers in 1941 to sell their right to receive that \$330,255.00 following 1965 for the insignificant sum of \$19,848.00?

A. I think I can truly say yes to that question.

The Court: His answer was 56 per cent of the \$19,000.00?

The Witness: Yes; taking all the factors into consideration I could say yes.

(Testimony of John H. Wents, Jr.)

Mr. Melville: I didn't get your Honor's comment.

The Court: His figure was 56 per cent of the \$19,000.00.

The Witness: Yes.

By Mr. Melville:

Q. That would make it how much?

A. Roughly about \$9,500.00, something like that; \$10,000.00.

Q. Would you advise your employers today, October, 1945, to sell that right to receive that much money, \$330,255.00 following 1965, on the same basis of appraisal as you have testified to here?

A. Taking the factors into consideration, go into this appraisal and analysis of that which will come after 1965, I [167] would say yes.

Q. Yesterday I asked you, Mr. Wents, to produce a complete list of the royalty sales data upon which you relied for your arriving at the discount factor of 43 1/3 per cent. Do you have that data with you this morning?

A. I couldn't compile a complete list because there were many, many, I told you. However, I have lots of the data available.

The Court: We will suspend at this time for a brief recess.

(A short recess.)

By Mr. Melville:

Q. Mr. Wents, I believe you testified yesterday that one of the factors which you took into consideration in arriving at your opinion of fair market

(Testimony of John H. Wents, Jr.)

value was the assumption that the seller would have a place to put his money which would be more advantageous to him than to leave it tied up in oil royalties; is that correct?

A. You will have to repeat that because I missed, I might have missed part of it. I want to be sure about it.

Q. I want you to be sure. I believe your testimony yesterday was to the effect that one of the factors which you took into consideration, in arriving at the fair market value, that is, the value at which the willing buyer and the willing seller would meet and agree, was that you presumed the seller [168] would have a place to put his money which would be more advantageous to him than to leave it in the oil royalties.

A. To be a willing seller, I believe that that factor would come into existence, yes.

Q. Can you suggest to this Court any place where a prospective seller could put his money, which would be more advantageous than to put nine thousand some dollars down on the line in 1941 for the right to receive, not a life annuity in 1965, but an estimated amount of money totaling \$330,255.00?

A. Well, that is beyond my province as an engineer and geologist. I would say that problem should be referred to an investment man.

Q. Then you don't know of any place that money could be better invested than that; do you?

A. I would say it would be a poor investment, myself; the nine thousand or whatever that figure

(Testimony of John H. Wents, Jr.)

is, to share in the oil which might be produced from that property after 1965, in accordance with our stipulation.

Q. Aren't you getting away from the stipulation?

A. No, I am not getting away from the stipulation.

Q. According to the stipulation and your testimony there will be received in all probability subsequent to 1965 oil royalties in excess of \$300,000.00.

A. Subsequent to 1965, that is true; how much subsequent, I don't know. [169]

Q. Now, Mr. Wents, yesterday I asked you to bring to court not all of the sales data which your files might disclose, but only those which you used in arriving at this formula or discount factor of 43 1/3 per cent. You said yesterday, I believe, that that 43 1/3 per cent was the mean between, or was the average of the various sales which were actually made, which you had analyzed?

A. Yes, that is true.

Q. That is correct? A. Yes.

Q. Do you have in court the sales which you analyzed and which resulted in your arriving at this average of 43 1/3?

A. I have a record of the sales which will disclose that that is the substance. I have a record—

Q. In what form is that record?

A. It happens to be in this form (indicating). I cite the royalty, the lease, the field, the percentage of which this transaction was a part, the price at

(Testimony of John H. Wents, Jr.)

which it was figured per barrel of oil, the discount factors, the per cent worth factors, the present value. I cite who the royalty was bought from, the date of the purchase, the purchase price, and the relationship of the purchase price to the present value as figured in the 10 per cent formula. That is my compilation.

Q. This folder you gave me, Mr. Wents, contains 15 or 16 pages similar to the one which is captioned "Superior Oil [170] Company—Ruhl Lease"?

A. Yes.

Q. That means that there were 15 or 16 sales that you analyzed in arriving at your percentage of 43 1/3?

A. There so happens to be 15 or 16 in that folder, but there probably are many, many more. There are many more.

Q. How many did you analyze in order to arrive at your 43 1/3?

A. I was in the business of appraising royalties for Diversified Royalties for approximately five years. The purchase of royalties by that organization, during that five years, amounted to approximately a million dollars a year. Probably there were ten million dollars or more of royalties submitted to that corporation, and in each case analysis was made of the present worth of that future income. I set forth a price which I figured was the fair market value or the fair price for the royalty interest. Included in that compilation is only a

(Testimony of John H. Wents, Jr.)

few, but there is enough of a swing there that it shows the average, in my estimation.

Q. Well, now, is it your testimony then that if we will take these 15 or 16 sales and do just as you said, average them all up to figure the relationship between the purchase price and the actual sales price, that we would arrive at a figure of 43 1/3?

A. Yes, the arithmetical average is around 43 1/3. But [171] the weighted average would be much lower than that.

Q. When did you arrive at that value figure of 43 1/3 per cent?

A. I arrived at that probably some time in 1936 or so.

Q. You have been using it ever since?

A. I have.

Q. Then if you have used that in—you have testified you have used that in valuing the royalties in this case as of 1941?

A. Yes.

Q. Then you didn't take into consideration any factors which developed or which a willing buyer and a willing seller would have known in 1941, which you didn't know back in 1936?

A. The same conditions with respect to prophecy in the future existed in 1936 as it did in 1941; five years didn't change it any.

Q. Have you checked your appraisal with any sales made subsequent to 1941?

A. I have not been in the business of buying and and selling royalties since 1941.

(Testimony of John H. Wents, Jr.)

Q. Do you know of any sales that were made on or during the year 1941? Do you know the facts regarding such sales?

A. Not as well as I do the facts regarding sales prior to 1941 and approaching 1941.

Q. Do you know of any sale that was made of oil royalties [172] in 1941 by anybody in Southern California, to anybody else?

A. The complete facts?

Q. Do you have knowledge?

A. Yes, I have knowledge of sales.

Q. What sales do you have in mind now?

A. There were royalties sold in the wells which were drilling on the west limb of the Dominguez field in the year of 1941 in drilling wells. I have knowledge that Wilmington royalties were sold in the year of 1941. But specific knowledge with respect to what might be recovered from those royalties or what the price paid for those royalties or whether the buyer knew what he was buying, or the seller knew what he was selling, I don't know.

Q. Is that true with respect to the years 1942, 1943, 1944 and up to date?

A. I hear of royalty sales and royalty purchases, but as far as making an analysis of royalty sales and royalty purchases of those on the outside, I have not.

Q. You have, then, as I understand your testimony, not made any attempt to check your method of appraisal, that you have used in this case, with

(Testimony of John H. Wents, Jr.)

any sales, actual sales which were made subsequent to 1936?

A. Why, yes. That is wrong because subsequent to 1941 would be the time.

Q. Did you testify that you reached this figure of [173] 43 1/3 per cent in 1936, or was it 1926?

A. 1936. I found no reason to make a change in it.

Q. Have you checked it with any actual sale of oil royalties subsequent to 1936? A. Yes.

Q. Tell me about it.

A. You will find them listed on the card there, the dates (indicating).

Q. There aren't any in here subsequent to 1938; are there? A. I don't know.

Q. Will you look and see?

A. (Witness complies): Yes, several.

Q. Show them to me.

A. June 18, 1939; January 23, 1939; March 7, 1939; February 18, 1939; August 29, 1939; January 27, 1939; January 16, 1939; January 26, 1939; February 2, 1939.

Q. Thank you. Now, let's take these you just referred to that were made in 1939. The first one is the royalty of O. D. Oil Company, H. B. No. 1. The field was Huntington Beach. Did you appraise that at any time? A. Yes, I did.

Q. What did you appraise it at?

A. I do not remember.

Mr. Mackay: Let him have the book. Maybe he can tell you. [174]

(Testimony of John H. Wents, Jr.)

The Witness: That particular royalty or this particular group of royalties are appraised here as a group. This particular sheet does not show the individual appraisal of that royalty. However, I believe it may be shown somewhere else. I don't know whether they are shown separately in there or not.

By Mr. Melville:

Q. Mr. Wents, the data with respect to sales you have brought to court this morning, in response to my request yesterday, all relate to rather small sales; do they not?

A. Well, it depends on what you mean by "small". Small is a vague term.

Q. Well, would you say that the oil royalties that we are valuing in this case are large?

A. In the Dominguez Estate case?

Q. Yes. A. Yes, they are large.

Q. That is also a vague term.

A. That is a vague term there. Let's split it.

In other words——

Q. In comparison, Mr. Wents, to the oil that we are dealing with in this case, do any of these royalties compare in any way in the size of the amount of oil involved or future royalties income to be received, or on any other basis are they comparable? [175]

A. With respect to the oil which we delivered from certain of these leases or can be expected from certain of these leases, the royalties included in this group in this book, shown in this book, in

(Testimony of John H. Wents, Jr.)

certain instances are larger than the barrels of oil reproduced in the Dominguez Estate leases.

Q. Would you call my attention, please, to the one you think is most comparable to the oil royalties we are trying to value in this case?

A. We have a spread of royalties across the Santa Maria field, where the recoveries from the leases and the ultimate recoveries will be several times the expectancy we have from the Dominguez Estate property.

Q. Show me in the book the one you are talking about.

A. Right here (indicating), the Fernandez lease, the Rosecrans lease, Vincent lease, Willis lease, Rice lease. There are others.

Q. The total barrels that we have here for all of these leases is how much?

Q. The total royalty barrels in this instance of this appraisal is 20,105.

Q. How does that compare with the total royalty barrels we are dealing with in this case?

A. If I were evaluating the same fractional interest in the Dominguez Estate case, as we have here, we would have a lesser figure in the Dominguez Estate case than we do in this [176] case.

Q. How many barrels of oil did we agree upon as the basis of the stipulation of facts in this case?

Mr. Mackay: Do you want the stipulation?

(Testimony of John H. Wents, Jr.)

The Witness: A grand total of 50,000,000, if I understand your question.

By Mr. Melville:

Q. That was comparable, you think, to the 20,105 here?

A. 20,105 does not reflect the same relationship between the fraction appraised in the Dominguez Estate Company and the fraction in that case. In other words, those two fractional interests are not the same. However, if I multiplied that recovery there by, or increased it so it was equivalent to approximately $16\frac{2}{3}$, we are appraising in the Dominguez Estate case, we would have a larger total there.

Q. But the fact is you are dealing with an actual sale of royalties in this case?

A. An actual sale.

Q. And the sale price was how much?

A. \$3,476.00.

Q. So you are comparing a sale of oil royalties for \$3,476.00 with oil royalties which you yourself appraise in the neighborhood of \$3,000,000.00?

A. Yes, there is that comparison there.

Q. Thank you. Mr. Wents, did you at one time make a [177] summary of oil developments and production on the lands of the Dominguez Estate Company and the Carson Estate Company, along about March 1, 1944?

A. I did. I believe that is the date.

Q. During your testimony in this case have you stated either on direct or cross examination all

(Testimony of John H. Wents, Jr.)

of the factors which you consider in arriving at your opinion as to the fair market value of the oil royalties involved? A. No, I have not.

Q. Did you state, in your book, and you may turn to page 6 if you want to check my quotation—— A. Which book is that?

Q. That is the one——

A. What is the title of it?

Q. "Summary 1942-1943 Oil Development and Production." A. Yes. What is the page?

Q. 6. Did you state in that report that a rise in oil prices "is thought to be inevitable"?

A. I did.

Q. Did you take that into consideration in arriving at the valuation that you have testified to in this case?

A. This report was made in, I think, you stated March or something of 1944. Considering it as of the date of June 5, 1941, I did not. I used the factor which was, or the price which is agreed upon by stipulation. [178]

Q. What made you think in 1944 that a rise in oil prices was inevitable?

Mr. Mackay: I object to that, not proper cross examination.

Mr. Melville: I want to show he certainly had the same reason to think that in 1941.

The Court: Overruled. He may answer.

The Witness: May the question be repeated?

Mr. Melville: Certainly.

(The question was read.)

(Testimony of John H. Wents, Jr.)

The Witness: I thought because of the demand which was had in 1944 and the lag in discoveries that an oil price rise should be had. I thought wrong, though.

By Mr. Melville:

Q. Would you read the rest of the paragraph, Mr. Wents, into the record?

Mr. Mackay: Just a moment. May I see it, first?

Mr. Melville: Yes.

Mr. Mackay: I want to see the book. Thank you.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

The Witness: That paragraph as a whole reads as follows:

“A rise in oil prices is thought to be inevitable. [179] To the owners of oil lands a price increase will mean much. It will encourage the extraction of the maximum recoverable oil by paving the way for reconditioning of old wells; it will make possible the application of costly secondary recovery methods; and, it will cause new wells to be drilled at locations now considered marginally profitable.”

Q. One more question, Mr. Wents. If before this trial is over the government produces witnesses who will testify that they were buying oil royalties and were in a position to buy oil royalties of this size in 1941, and if they testify they would have been glad to have bought these at figures between four and five million dollars, would that testimony from

(Testimony of John H. Wents, Jr.)

willing buyers change your opinion? A. No.

Mr. Melville: No more questions.

Redirect Examination

By Mr. Mackay:

Mr. Wents, you just referred to page 6 and you read a paragraph, I think. May I see that a minute?

A. Yes.

Q. Mr. Wents, you were asked to read by counsel, I think, a paragraph on page 6. Will you please read paragraphs on 6, 7 and 8 and the middle of page 9?

Mr. Melville: Let's put the whole book in, if you want to, Mr. Mackay.

Mr. Mackay: I don't want to put the whole book in.

Mr. Melville: Let's see what he wants to read.

Mr. Mackay: O. K.

Mr. Melville: I object to this, your Honor, on the ground it recites factors which developed between 1941 and 1944 when the book was written. I appreciate that opposing counsel will point out I just took one paragraph from this book. All I was dealing with was general factors which caused this witness to believe in 1944 that a rise in the price of oil was thought to be inevitable. The purpose of my questioning was to establish those same factors were present in 1941. The purpose for which opposing counsel purposes to get in several pages, is to bring into the record factors which couldn't have been known in 1941.

The Court: It is doubtful to me if any of it

(Testimony of John H. Wents, Jr.)

should be read into the record here. Your witness is present and either side may, of course, interrogate him upon any proper subject. If he states now something contrary to what he has stated at some other proceeding or some other time he may, of course, be interrogated upon it. I know of no reason for putting into this record lengthy quotations from something the witness may have written elsewhere or for some other purpose.

Mr Mackay: If your Honor please, the only purpose [181] I have for doing it is that counsel picked out one paragraph. The next paragraphs here will help clarify that. Counsel, when I objected to going into 1942 prices said, "Well, it is necessary to do that," so he jumps into 1944. Now, it isn't just the price of oil that has a bearing upon the value here.

The Court: How is this going to help us in determining our present question of the valuation of these oil royalties?

Mr. Mackay: Your Honor please, I don't think that the price in 1944 does. I will have to agree with you. But I can't understand——

The Court: The witness is here and if you have anything further you wish to bring out from him on direct examination you, of course, may do so. I don't think——

Mr. Melville: I would like to be heard in response to Mr. Mackay's remark; this is clarification of the paragraph I had read into the record.

(Testimony of John H. Wents, Jr.)

The Court: I don't care to hear you at length. I don't think it is necessary.

By Mr. Mackay:

Q. Now, Mr. Wents, you were asked by counsel yesterday to get a list of the sales that you were familiar with of oil royalties in Southern California? A. Yes. [182]

Q. I understood you to say this morning you had prepared this and brought this book to court, and counsel has asked you several question upon it. I will ask you if you made a valuation of the, or for the Superior Oil Company of the Reyes Lease in the Rio Bravo Oil Field?

A. I made a valuation for the Superior oil lease, not the Superior Oil Company.

Q. Did that involve a royalty interest?

A. A royalty interest, yes.

Q. You made the valuation for whom?

A. I made the valuation for Diversified Royalties.

Q. Did it buy the——

A. Diversified Royalties bought the royalty interest.

Q. From who, Mr. Meeks? A. Mr. Meeks.

Q. What is the date of that purchase?

A. The date of that purchase was June 21, 1938.

Q. What was the purchase price of that?

A. One-quarter of one per cent in the lease was purchased for \$4,500.00.

Q. Now, had you determined the present worth on that?

(Testimony of John H. Wents, Jr.)

A. On the appraisal shown on this page I had appraised one-sixteenth of that one-quarter per cent, using one-quarter of the purchase price as the basis, and making that appraisal I used a price of \$1.54 per barrel as the future revenue. I [183] used the present value factors identically that I have used in the present appraisal. I determined the present value of that future income, and then by dividing that present value by that purchase price I found the relationship of $38\frac{1}{2}$ per cent was had.

Q. Now, did you also make a valuation in the Wagner lease?

A. The Wagner lease, yes.

Q. And that was a royalty interest, too?

A. It was a royalty interest.

Q. And was that purchased by—

A. Diversified Royalties. It was purchased by Diversified Royalties.

Q. When was that purchased?

A. April 7, 1938.

Q. What was the purchase price?

A. One-eighth of one per cent was purchased from Ten Eyck, a geologist, for a price of \$3,500.00.

Q. What was the relationship of the purchase price to the present value you determined?

A. The purchase price is 42.39 per cent of the present value.

Q. Did you make an examination of the royalty interest in the Ramsey lease? A. I did. [184]

(Testimony of John H. Wents, Jr.)

Q. Was that purchased by the Diversified Royalties? A. It was.

Q. What date?

A. It was purchased on May 16, 1938.

Q. From whom? A. L. V. Smith.

Q. At what price?

A. The price was \$2,500.00 for one-eighth of one per cent.

Q. What was the relationship of the purchase price to the present value you determined?

A. The relationship was 56.28 per cent.

Q. Did you also make a valuation of Section 7 Lease in the Coalinga oil field? A. I did.

Q. What interest did you value there?

A. I valued 1/48th of one per cent, but on the same basis of valuation for 1/4 of one per cent.

Q. Who was that purchased by?

A. That was purchased by Diversified Royalties.

Q. From whom?

A. From E. A. Parkford, an oil operator.

Q. Mr. Parkford is a rather successful oil operator? A. Yes.

Q. What was the purchase price?

A. The purchase price was \$30,000.00. [185]

Q. What was the relationship of the purchase price there to the present value?

A. The purchase price was only 39.29 per cent of the present value.

Q. Now, how many royalty interests in this book you have here, aside from those I have given you——

(Testimony of John H. Wents, Jr.)

A. There are probably 50 or 60. Here is a group of 2, 4, 6, 8, 10—20 there on that one page.

Q. 20 on that one page? A. Yes.

Q. And did Diversified Royalties buy all those mentioned here? A. Yes, they did.

Q. Approximately what was the relationship of the purchase price to the present worth?

A. The purchase price was approximately 57 per cent of the present worth.

Q. Now, Mr. Wents, I think on cross examination you were asked, among other things, that based upon the estimated oil reserves and the probable future production set forth in the stipulation, that an investor by paying a price that you say is a fair market value would derive property upon which he would get 18 per cent compound interest. I think your answer to that was you said there may be many things that would not permit such a handsome return. What do you have [186] in mind that may happen to prohibit such a fancy return?

A. I will have to explain a little bit. In timing the oil which will be produced from the various properties going into this appraisal we are governed, or the engineer is governed by certain things. In other words, it is his opinion that certain things may or may not happen. And the result is he follows the curve which he has developed and distributes that oil over that period of time, which is disclosed by the curve.

Now, in many instances interruptions can be had

(Testimony of John H. Wents, Jr.)

in the production of the oil. The control of production is not in the hands of the land owner or the royalty interest owner. It is in the hands of the operating company. They can see fit to prorate to the extent whereby the time that we figured or the time, as I figured, might be prolonged for a period again as long.

Then there are interruptions, unforeseen interruptions which might happen, say, such as an earthquake may sever the casing strings on a number of prolific producers; while it does not interfere with the oil produced, it defers production date. Then again there may come into being some other fuel or more efficient fuel than gas or oil. And as a consequence the demand might be lessened. All those things are things which would not change the ultimate recovery from the property, but may materially change the productive rate. [187] And those are the things which must be lumped into one basket and a hazard applied to take them into accord.

Q. You speak of an earthquake. Do you know, in your experience, whether an earthquake in California has ever broken the oil lines? A. Yes.

Q. When and whose property?

A. Well, subsequent to the appraisal date it happened on a portion of the Dominguez Hill. Prior to the appraisal date it had caused a serious disruption on the production on Signal Hill.

Q. Signal Hill, that isn't very far from Dominguez; is it?

(Testimony of John H. Wents, Jr.)

A. About six miles, from the center of field to center of field.

Q. Well, what happened with the earthquake subsequent to this date? What did it do to the field in Dominguez?

A. The effects of that earthquake were sufficient to cause a material change in the productive curve of the entire State of California for the year of its occurrence. That was in 1933.

Q. Well, were many wells knocked out?

A. That is what would cause and disrupt the productive curve.

Q. Subsequent to 1941 has there been any earthquake? [188]

A. In the easterly end—

Mr. Melville: I object, your Honor. That is going to situations developed in 1941. He couldn't possibly consider that in 1941.

The Court: Overruled.

The Witness: Subsequent to 1941, in the late fall of 1941 an earthquake struck the west end of the Dominguez Field, affecting almost every well on the Havenstrite-Larronde lease and affecting 10 or 12 wells, I believe, on the westerly end of the Union Oil-Callender lease, as well as certain wells on the Union Oil-Austin lease.

The Court: You don't need to go into detail. Your answer is they have had some effect since '41.

By Mr. Mackay:

Q. Was it necessary to rebuild the wells on the Havenstrite?

(Testimony of John H. Wents, Jr.)

A. It was necessary to rebuild certain of the wells on the Havenstrite.

Q. Well, now, Mr. Wents, you were asked by counsel to refer to a summary of 1942 and 1943, which bears date March 1, 1942, page 6, with respect to raise in price. Now, did you, when you made that summary, also give consideration to the future drilling of the Dominguez Oil fields?

Mr. Melville: Those are exactly the same pages I [189] objected to before and the court sustained my objection.

The Court: The question as framed, the objection to it will be overruled. You may answer.

The Witness: Yes, I did.

By Mr. Mackay:

Q. What was your comment at that particular time about that?

A. That the leases of the Dominguez Estate Company and Carson Estate Company on Dominguez Hill had been more or less fully developed and there would be very little future drilling on those leases.

Mr. Mackay: I think it is all, your Honor.

The Court: Will there be any recross examination?

Mr. Melville: Yes, your Honor.

The Court: You may proceed.

Recross Examination

By Mr. Melville:

Q. Are the stipulated figures, Mr. Wents, your

(Testimony of John H. Wents, Jr.)

own figures as to the probable future production rates?

Mr. Mackay: If your Honor please, we have stipulated what the future, probable future production is. We had many conferences on it and we arrived at it. I don't understand the purpose of this question.

The Court: The objection may be overruled. He may answer. [190] Do you understand the question?

The Witness: Yes, I do.

The Court: Answer it.

The Witness: The answer is yes.

By Mr. Melville:

Q. You mentioned on redirect examination the matter of operating companies. Who are the operating companies involved in our leases in this case?

A. With respect to the Reyes lease, the Union Oil Company, Dominguez Oil Fields and Shell Oil Company are the operators. With respect to the DeFrancis lease, the Tidewater Associated Oil Company is the operator.

Q. With respect to the largest lease, Reyes lease, are not those operating companies considered to be tops, the best that are operating in Southern California? A. You will have to be more——

Q. They are entirely competent operators; aren't they?

A. In the opinion of some people I would say yes. It depends on what view you take of the picture. I say yes.

(Testimony of John H. Wents, Jr.)

Q. You consider those companies that are operating the Reyes lease to be entirely competent?

A. They are competent.

Q. Mr. Wents, what do you mean by a field that is fully developed to settle production?

A. By the statement "fully developed to settle production" I am assuming, in making that statement, that the necessary wells have been drilled upon the property and the decline rate has reached a constancy; it is not erratic one way or the other. There is a constancy in the declining rate on the property.

Q. Are all the leases involved in our case on oil property that is fully developed to settle production?

A. No, they are not.

Q. Do you consider it good practice, Mr. Wents, to apply your same discount factors of 10 per cent and 43 1/3 per cent in valuing the oil properties that are fully developed to settle production, as you do in valuing oil properties of undeveloped oil reserves?

A. In certain cases I do; in certain cases I do not.

Q. Can you be more specific?

A. In the specific instance you have reference to here I happen to be engineer, not only for the Dominguez Estate Company, but for each of the companies operating on the Dominguez Estate property. I know what their plans for future development are, because they are my plans. I engineer the operation of the well from the com-

(Testimony of John H. Wents, Jr.)

mencement of its location through to its completion.

I engineer the production on that well after completion with the full knowledge on the part of the Dominguez Estate Company I am so doing, and their consent. I am working for [192] both parties for the betterment of both. Under those circumstances I believe I can set forth a development program, as well as a program which will anticipate certain productions at times with sufficient relation to the set fair market value as I do on any.

Q. If the circumstances were different and you were not the geologist and engineer on the property and so forth and so forth, then do you think you would be justified in using your same 10 per cent and $43\frac{1}{3}$ per cent in appraising undeveloped properties, as you use in appraising the developed properties?

A. The discount I would choose to use would be entirely based upon my knowledge of what the operator would be likely to do, as well as the materials and condition of the lease. I may or may not use the same; that would be just a case of judgment on my part, what I would use.

Q. Tell me whether you have, ever since 1936, when you adopted this formula, used any other formula.

A. For the valuation of oil royalties and property interests the basic formula, this is the basic formula. I have sometimes shortcutted the formula by assuming an average discount comparable to my

(Testimony of John H. Wents, Jr.)

knowledge of what might be expected, and have sometimes also converted to barrels, in royalty barrels per day, and things like that. Actually it comes back to the same thing. It is only because I have had a lot of [193] experience in dealing with properties which are quite similar that would allow me to make the deviation. In any of my written reports, prepared for any of my accounts, I have not deviated, that I know of.

Q. Tell the court, if you will, about any specific case where you have deviated.

A. I can't remember any case where I have deviated, offhand.

Q. What oil fields were these various leases in that, upon redirect examination, you testified as to sales running from \$2,500.00 all the way up to \$30,000.00?

A. Those fields, that were mentioned there, were Rio Bravo, Coalinga and I think Huntington Beach; I am not sure.

Q. Is Rio Bravo a developed oil property or was it at the time you made that appraisal in 1938?

A. It was developed to the extent where I felt assured the development would take place along certain lines.

Q. Would you say it was a fully developed property up to settle production, up to 1938?

A. No, I could not answer that question.

Q. You can answer it yes or no.

A. I couldn't answer. I am sorry. I couldn't

(Testimony of John H. Wents, Jr.)

answer it without explanation. In other words, the property was not fully developed or certain of these properties were not fully developed. Others of them were in the Rio Bravo [194] Field as of that time.

Q. Take this Superior-Ruhl lease, now, that you valued in 1938—rather, a sale was made in 1938 for \$4,500.00. That is on the Rio Bravo property?

A. Yes.

Q. On the particular property where that lease was, would you say that the oil property had been fully developed to settle production in 1938?

A. I am trying to remember back to that time. I believe the Ruhl lease was developed by three wells as of the time it was appraised. And that those three wells constituted the total drilling to be expected under the terms of the lease as of that time, as well as the other lease, the Ramsey lease, that was developed to a slightly greater tenancy. I am trying to place myself back to 1937 or '38 there, and the maps.

The Court: We will suspend at this time until 2:00 o'clock.

(Whereupon, at 12:30 o'clock p. m., a recess was taken until 2:00 o'clock p. m. of the same day.) [195]

Afternoon Session 2:00 p.m.

JOHN H. WENTS, JR.

resumed his testimony as follows:

(Testimony of John H. Wents, Jr.)

Recross Examination—Resumed

By Mr. Melville:

Q. Mr. Wents, my attention has been called to a qualification you made this morning, in answer to my question about your testimony in the United States District Court case. I believe you testified you had appraised that at roughly \$10,000.00, that oil property? A. Yes.

Q. When I asked you if it wasn't true that the jury brought in a verdict of \$20,000.00, or twice your appraisal, you made some qualification. I would like to clear it up for the record.

A. I would like to clear it for the record. In that particular instance there were two things involved, one was the value of the equipment, the physical equipment on the well; the second was the value of the oil reserves. For some reason the two had not been taken simultaneously. In other words, they took the oil and at a later date found that in taking that oil they should have also provided for the physical equipment.

As a consequence, there was a semi-confusion or a [196] confusion in the proceedings to the extent that two values were allowed to be set up, when only one reasonably could be set up, because the value of the physical equipment as of the date of reserve exhaustion is a very negligible thing.

The Court: I suggest we not go too much into detail on the suit that has been tried. Make your explanation rather brief, if you will.

(Testimony of John H. Wents, Jr.)

The Witness: (Continuing) In so doing they sat up a value for physical equipment, which was far out of proportion to my value. That accounts for the difference in my appraised worth of the property and the judgment which might have been rendered.

By Mr. Melville:

Q. Did you value only the oil properties there or all the properties, including the equipment?

A. I am valuing all the properties, including their equipment; those which are coming to trial.

Q. Those which are coming to trial?

A. One of them has been tried; others are still in the process.

Q. All right. Mr. Wents, about these sales that you testified to on recross examination, we were talking about the Superior-Ruhl lease in the Rio Bravo Field and others following that. Do you recall the testimony? A. I believe I do. [197]

Q. Which of those fields were fully developed to settle production at the time of the sales?

A. The specific properties that we were concerned with or we talked about, in my opinion, were fully developed at the time of the sales and production was settled by virtue of the exercise of curtailment upon the properties. Those properties were producing in accord with the Umpire's formula.

Q. Your testimony, then is they were all fully developed to settle production?

(Testimony of John H. Wents, Jr.)

A. The properties that you have mentioned, the Rio Bravo.

Q. How about the Coalinga oil field?

A. The Section 7 lease that I testified with respect to was partially developed, but, in my opinion, the proven area had been established.

Q. Will you go ahead and state which of the others you testified to were fully developed and which were not?

A. The list would have to be read off to me. I believe that Mr. Mackay has the book I was using.

Q. Was the Wagner lease on fully developed property? A. Yes, it was.

Q. How about the Ramsey lease?

A. Fully developed. We did not use that one.

Q. What depths were these properties producing from that you testified to? [198]

A. Which properties?

Q. The same ones that Mr. Mackay asked you about on redirect examination?

A. Are those the ones we have just discussed now, or others?

Q. The Ruhl lease on the Rio Bravo oil field, the Wagner lease on the same field.

A. 11,000 feet, roughly.

Q. Isn't it true, Mr. Wents, that when you are producing from such an extreme depth as that it is more hazardous than if you are producing from, say, 5,000 feet?

(Testimony of John H. Wents, Jr.)

A. I can't understand your question there. What do you mean by "more hazardous"?

Q. Aren't there more dangers of not getting the oil that is in the ground out of the ground if you are trying to pull it up from 11,000 feet than if you are only trying to pull it up from 5,000 feet?

A. No.

Q. Were these same properties rather new wells in 1938?

A. The wells were probably two, three, four and five years old.

Q. They were still in flush production?

A. Production on those properties was curtailed. 330 barrels a day was the daily rate, and they had initial [199] production of several thousand barrels.

Q. I understand the production was curtailed. If the production hadn't been curtailed, the fact the wells were fairly new would have given flush production; wouldn't they?

A. In that case we have no reliable decline curve to go against, and as a consequence, we estimate by volumetric methods the recoveries.

Q. In summing up your testimony then, Mr. Wents, is it true that in making valuations both before and after 1936 you have used in all cases a 10 per cent discount factor and then a $43\frac{1}{3}$ discount factor?

A. My valuations had been for the purpose of setting forth my opinion with respect to fair market value; that is the procedure I have followed.

(Testimony of John H. Wents, Jr.)

Q. That has been true whether it was during depression or boom times?

A. It doesn't make any difference.

Q. Mr. Wents, if the prospective or hypothetical buyer that you had in mind when you valued these properties had paid the three million, some thousand dollars you have testified to, as the fair market value, if he had paid that in 1941 when would he have received all of his money back?

A. I don't know.

Q. Don't we have in evidence an exhibit that would enable you to express an opinion as to that?

A. No. We have in evidence an exhibit which shows the payments——

Q. Probable future?

A. ——which would accrue from that. However, there is a lot of difference between the payments which might accrue from that and what he might have had back in the way of his money, because the income tax drag on those payments would have been terrific.

Mr. Melville: No more questions.

Redirect Examination

By Mr. Mackay:

Q. Mr. Wents, are you a member of the American Petroleum Institute? A. I am.

Q. Do you belong to any other professional society?

A. I belong to the American Association of Petroleum Geologists.

Q. You said you did not get a degree. How many

(Testimony of John H. Wents, Jr.)

credits did you get towards that, do you remember?

A. In the geological and allied engineering and petroleum engineering sciences approximately 130 or 140 hours of credit, against 45 hours which are required of a degree.

Mr. Mackay: That is all.

Mr. Melville: Mr. Wents, why didn't you get a degree? [201]

The Witness: Mr. Melville, I was interested in getting out in the profession and making my way. As a consequence I attended Stanford for four years and attained the ground work. Immediately upon completing that I went to work in the oil industry. After working in the industry approximately seven years I went back and took additional work, during a period of five years, amounting to almost the same course I took in college, except in graduate work at U.S.C. There were a number subjects required of certain college degrees. I didn't see where they were going to help me much.

Mr. Melville: That is all.

(Witness excused.)

Mr. Mackay: I will call Mr. Paine.

PAUL PAINE

called as a witness by and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

(Testimony of Paul Paine.)

Direct Examination

The Clerk: State your full name for the record, please.

The Witness: Paul Paine.

By Mr. Mackay:

Q. Are you a resident of Los Angeles?

A. Yes, sir. [202]

Q. What is your occupation, Mr. Paine?

A. I am an engineer and I work in the oil fields.

Q. Are you a graduate engineer?

A. Yes, I graduated from the Massachusetts Institute of Technology?

Q. Will you please relate briefly your educational qualifications?

A. That was in 1905 I came west and for several years worked in the mines and did field geological work for the United States General Land Office in the prosecution of land frauds and in connection with the classifications of mineral lands until 1908.

Then I entered the oil fields, and since then I have been continuously connected with oil field operations.

Until 1917 I worked in the California fields. The latter part of that period as field superintendent of Honolulu Oil Company. I then went to Oklahoma with the Gypsy Oil Company. The operating unit in mid-continent area of Gulf Oil Corporation.

In 1921 I cut loose on my own hook, and since then I have had no regular continuing corporation

(Testimony of Paul Paine.)

connection except those small companies in which I have a substantial interest, and also except several years I was on the Board of Directors of Union Oil Company, and one year, from the middle of 1922 until the middle of 1923, when I was vice president [203] of the Shell Company of California, in charge of its production operations.

I should add I do have two other connections. For the Kern County Land Company, I am on its Board of Directors, and am concerned with its oil affairs. And for the Bank of America, I am the consulting petroleum man, which means chiefly passing on oil loan applications.

My partners and I drill wells and produce oil in a small way. And in addition to that I have an engineering practice which is concerned almost entirely with the valuation of oil properties and of oil companies.

Q. What is the form and scope of your valuation consulting engineering practice, Mr. Paine?

A. Well, that takes several forms. First, in connection with loans where the value of a property is related to the merit of it as security for a loan and its capacity to pay back the loan. Work of that kind I have done for the California Bank, Bank of America, the Chase National, the Equitable Life Insurance Society.

A second class of work is that which is done for the oil companies themselves in connection with the sales and purchases of properties, mergers, dissolutions and a variety of work where not in spe-

(Testimony of Paul Paine.)

cifically it is desired to bring in an outside engineer either to supplement an engineering staff or to act as referee. I have done work of that character [204] during recent years for Shell Company, Honolulu Oil Company, Pacific Western Oil Company, Standard Oil Company, Indiana, Pan American Petroleum, Wolverine, Midwest Oil Company, Amarado Petroleum Corporation.

The third class of work is for the bankers in connection with the issuance of securities and particularly with reports that are prepared for their deals of that kind and for the papers which are required by the Securities and Exchange Commission and the certificates which must go to the Securities and Exchange Commission. Work of that kind I have done for Morgan, Stanley & Company; Dillon, Reed & Company; Smith, Barney & Company; Blythe & Company, Inc.; Dean Witter & Company.

Another kind of work not so closely related to that is the consulting and advisory work which one does for the land owners or lessors who occupy the lease or position in contrast with the lessee position, which the operating company has. Work of that kind I am doing or have done recently for Kern County Land Company, the Porter Ranch, Pleasant Valley Farm Company, Metropolitan Life Insurance Company, Hillcrest Country Club, Twentieth Century-Fox Film Corporation.

Q. Now, in your experience as a consultant, engineering consultant, have you had occasion to make valuations in determining fair market value

(Testimony of Paul Paine.)

of properties for purchases and [205] sales?

A. Yes.

Q. You have done quite a bit of that, haven't you, Mr. Paine?

A. Yes.

Q. You have testified on many occasions, have you not, as to the fair market value of properties?

A. No, I have not.

Q. You have never testified?

A. This is my fourth appearance in court in 15 years. Except for a series of appearances for the Attorney General and District Attorney in connection with these criminal prosecutions of people fraudulently selling lands represented to be oil lands out of that group, which I did as a public service, I think this is my fourth appearance in court in 15 years.

Q. Were you employed to make an appraisal to determine the fair market value of the oil royalty interests of the Dominguez Estate Company on June 5, 1941?

A. Yes.

Q. You have made that appraisal; have you?

A. Yes.

Q. Are you familiar with the stipulation that has been filed in court here and the exhibits?

A. I think I am. I have been supplied with copies of [206] the stipulation.

Q. You made an analysis of the information therein contained?

A. Yes.

Q. You have made other analyses, too, have you, of other things that may have a bearing on fair market value?

(Testimony of Paul Paine.)

A. Of this property?

Q. Yes.

A. Yes. I have known the property for some time and have been on it.

Q. You have been on it?

A. Yes. Oh, yes.

Q. How long have you known the property, Mr. Paine?

A. I can recollect walking over it before there were any derricks on it; that was in 1922. Long intervals elapsed after that when I wasn't on it. I don't mean I have been on it a great deal; I have been on it a good many times.

Q. Can you tell the court what is the basis of your valuation?

A. The basis of my valuation was an estimate or opinion of the meeting ground of a willing buyer and a willing seller; that is, a buyer that was willing and able to buy and a seller that desired to sell, that wasn't forced to do so, with both of those having full knowledge of the facts. Along with that was my knowledge of the property and the [207] specific data supplied by you in the stipulation.

Q. You have recently been down to the property; haven't you?

A. Yes, about six weeks ago, I think, I was there; about six weeks ago it was. And I was on the property several times in the spring of 1941.

Q. You were? A. Yes.

Q. Now, Mr. Paine, will you tell the Court just

(Testimony of Paul Paine.)

what factors you take into consideration in arriving at your opinion as to the fair market value of the oil royalties of the Dominguez Estate on June 5, 1941?

A. I took into account your stipulation, first, the estimate agreed to of the oil reserves and of the revenue that would provide.

I also reconstructed my opinion of how the buyer and the seller would view this property and the various factors which would be taken into account by them, namely, the daily production which the property was then producing and a measurement of—not a measurement, but an estimate of how they would view the value of that oil in the ground per barrel and of the number of years it would take for them to get this money back. These are all indices used by buyers and sellers in their transactions. I endeavored to reconstruct the conventional persons, the willing seller and the [208] willing buyer, how they would view this in making the deal.

Q. Now, you speak about the daily production. Will you please tell the Court what significance that average daily production has in arriving at the fair market value between a willing seller and a willing buyer?

A. Buyers and sellers of properties use that as one means of measuring the merits of property, so many dollars of the daily barrels of production; if a property has 10 barrels a day of production, to a certain interest and if they should consider

(Testimony of Paul Paine.)

that to be worth \$1,000.00 a barrel, the property is measured as being worth \$10,000.00. Just as real estate is directly dominated as having a value of so many dollars per front foot. It is a short cut. It is one that is used widely.

Q. Did you also make an engineering appraisal?

A. Only insofar as I took the official stipulation.

Q. That is what I mean.

A. And followed it. I followed that out and converted that into a so-called engineering or analytical valuation. Then I converted that into an expression of market value. And after I had done that—I haven't much respect for it, but I did it.

Q. Do you remember what value you got in doing that? In other words, Mr. Paine, what I would like to have you do is tell the court how you arrived at these fair market values. [209]

A. I made this so-called engineering appraisal in which I discounted the anticipated future revenue as it had been stipulated, using a 5 per cent factor. And then I observed, however, that no allowance had been made here in the stipulation for the effect of income taxes.

Q. Well, the stipulation was not intended to arrive at any value, just to put down some indices of that.

A. No. After all, the stipulation, all of this process is not a valuation. It is simply an estimate of future profits and their present worth. So I ascertain a present worth based upon a 5 per cent discount factor, which arrived at a figure.

(Testimony of Paul Paine.)

Then I applied a further deduction for the effect of income taxes, which would be levied against this, which was entirely an estimate, and which, in my instance, was 30 per cent deduction.

Now, with that figure arrived at, there was an estimate, an engineering estimate of the present worth of the anticipated future profits, which this property would provide after paying the costs and the income taxes.

Now, I converted that then to an estimate of market value by multiplying by .625. My reason for .625, that is, 62½ per cent of that—my reason for doing that was I have observed in a great number of instances the actual market value of a property seems to end up in the range between 60 [210] and 65 per cent of the valuation which one gets by applying a discount factor of 5 per cent or 6 per cent to the anticipated future profits. That is a general rule; there are many variations from it. That was my engineering appraisal.

On that basis I arrived at a figure of \$2,720,965.00. Shall I go ahead?

Q. Go ahead and explain it.

A. The property at that date was producing or had the first five months of 1941 produced an average of 1520 barrels a day net royalty oil to the interest of the lessor.

Now, I consider the value of that to be in the range from \$1,500.00 to \$1,800.00 per daily barrel; that is, \$1,650.00. It amounted to \$2,508,000.00.

(Testimony of Paul Paine.)

At \$1,800.00 per daily barrel it amounts to \$2,700,000.00.

Another method of estimating the value of a property is at a rate per barrel in the ground. I considered the value to be 40 cents per barrel against the stipulated oil reserves of 7,992,871 barrels.

Q. Why do you do that, Mr. Paine?

A. Because you had stipulated that.

Q. I know, but what do you mean by 40 cents per barrel—why do you do that? Let it go.

Mr. Melville: I would like to have it answered.

Mr. Mackay: I withdraw the question. [211]

By Mr. Mackay:

Q. You may proceed with your answer.

A. Another method of ascertaining the value of a property is the percentage of the ultimate return. Very often the buyers of property are not so fussy about when the oil is coming in, they don't pay any attention to these engineering estimates. If they estimate the property is going to return so much money over its entire history, they will pay on the basis of getting three for one, or two and a half for one or four for one, or five for one, depending upon the circumstances. Now, at a return of four for one the value of this property would be \$2,257,495.00.

At a return of three for one, on the stipulated return to which you had agreed to, the return would be \$3,009,993.00.

Another method of measuring the value of such

(Testimony of Paul Paine.)

properties is on an annual pay-out basis. The buyer likes to figure on how soon will he get his money back. Two courses are followed there. He may take the current rate of revenue and multiply it by so many years, or he may take into account this decline which is almost inevitable in all oil properties after they have passed their peak of production. [212]

Now, the average return per barrel, according to your spitulation, is \$1.13 a barrel. And the rate of production was 1520 barrels per day. So that at that rate of production, multiplied by 365 days, arrives at an average annual production of 554,800 barrels, which at \$1.13 would indicate an annual return of \$626,924.00, provided there were no declines or changes in the rate of production.

Now, that rate multiplied by five years equals \$3,134,620.00. At four years it equals \$2,504,896.00.

On the other hand, when considering that point of view, a buyer instead of multiplying the present annual rate by so many years will draw up a projected decline rate and see where that is going to bring him out; following some pattern.

Now, on the pattern which I think would have been followed in this property and on a seven-year pay-out basis, assuming he received \$600,000.00 during the first year and there was a gradual decline, a seven-year pay-out would have returned to him \$3,252,000.00. All without any consideration of the effect of income taxes.

Now, there is another method of appraising properties which may be applicable here. It is the other

(Testimony of Paul Paine.)

one, I think, could even be considered here, although there are other methods of valuing property which would not be pertinent here; that is the acreage per cent. We have a unit which registers the rating value of one per cent of the oil from one acre. Thus if I am buying one percent of the oil from 40 acres, I am buying [213] 40-acre per cent. There is much trading done using that unit. Using a figure of \$250.00 an acre per cent brings us out with a value on that basis of \$2,711,740.00.

I want to add that I don't think that consideration has any merit here. The result is I had all these valuations representing my conception of the meeting ground of these hypothetical persons, and I wrapped them up—did not average them, but just weighed them mentally and landed on the figure of \$3,000,000.00 for the property.

I confess I didn't like it. I wanted to come out with something less broad, either something over \$3,000,000.00 or under. But an effort to do that failed. I should add, however, that if I were to deviate from that either way I should have made it three million one rather than two million nine.

Q. That, in your opinion, represents the fair market value of the royalty interest of the Dominguez Estate Company on June 5, 1941?

A. That is my estimate of that, yes.

Q. Now, Mr. Paine, may I ask you, you spoke about the Kern County Land Company, that is a company up in Kern County; isn't it?

A. Yes.

(Testimony of Paul Paine.)

Q. It owns lands? A. Yes. [214]

Q. It has royalty interests? A. Yes.

Q. It has leased its land? A. Yes.

Q. You have passed upon the values of oil royalties in a great many instances; haven't you?

A. Yes.

Q. You made appraisals for the buyer and the seller or for banks or anybody interested; haven't you? A. Yes.

Q. Will you tell the Court, have you had experience in valuing stocks and securities?

A. Yes. I have been concerned with the values of oil securities particularly.

Q. You did considerable work along that line?

A. Yes, I have.

Q. For banks and for the underwriting houses?

A. For the underwriting houses; not for the banks. Rather for the investors and the underwriting houses, for the investment trusts.

Q. Now, you made a statement there, speaking about the average daily production of 1520 barrels in 1941. I think you stated that you assigned a value of \$1800.00 per barrel. Do I understand that correctly, Mr. Paine?

A. Yes. I spelled it both with \$1650.00 and \$1800.00. [215]

Q. I see. Well now, why did you use \$1650.00 and \$1800.00? Can you explain to the Court how you arrived at that?

A. The transactions that had taken place if put back into that term showed that that was a proper

(Testimony of Paul Paine.)

index. I mean we were at times buying royalties on the basis of a thousand dollars a barrel and other properties were selling on the basis of \$500.00 a barrel. The unit per barrel varied widely under different circumstances. I don't know that I can for you mathematically——

Q. I don't want you to. I want a question of judgment.

A. Why I used \$1650.00 or \$1800.00 I can't tell you, any more than the real estate man can tell you why this business property out here is worth \$700.00 a front foot. The figures I used reflect what I consider to be the units that would have been used by the buyers and the sellers on a transaction at that time.

Q. You obtained them from your experience and use and your judgment; isn't that correct?

A. It was based on my experience and observation, yes.

Q. You have brought and sold or assisted in the purchase and sale of royalty interests on that basis; haven't you?

A. I have bought and sold them myself. I own them and I am concerned with them, yes. [216]

Q. You have sold them on the basis of the average daily production at a certain price; haven't you?

A. That is one of the measures we use when we are considering what we are going to ask for it. I don't think it is a conclusive one, by any means. I don't think any of these courses is the final answer.

(Testimony of Paul Paine.)

I think they all represent things which would be taken into consideration by a man who is going to make a deal.

Q. Then do you think that an informed buyer would take all those things into consideration?

A. I think so.

Q. As well as an informed seller?

A. Yes. A smart buyer will say, "How much is that per daily barrel?" Oh, yes.

Q. You know that is what the buyers generally ask; don't you? A. Usually.

Q. Do I understand that your value of \$3,000,000.00 for your royalty interest of the Dominguez Estate Company on June 5, 1941, is based upon all these matters you have taken into consideration, and you have weighed them and that is your best judgment, based upon them?

A. Yes, that is it exactly.

Q. And I understand you to say your analytical appraisal, that you did take the estimated oil reserve and the probable [217] production; did you not?

A. Oh, yes, in all these computations I did not deviate as far as reserves and revenue and so on from your stipulation.

Q. Now, Mr. Paine, did you also make an appraisal of the royalty interest of the Carson Estate Company?

A. Yes. I considered that to be worth \$283,000.00.

Q. Will you please tell the Court how you arrived at that?

(Testimony of Paul Paine.)

A. Well, I arrived at it pretty quickly. I took the pattern of expected future return and I think I took a six-year pay-out figure. I didn't go through all of these processes on the Carson property. I remember that one reason for that was at that time I did that I didn't have your stipulation with respect to the barrels in the Carson Estate, and so I relied upon the estimate of revenue. Since then, since getting all these figures I have reviewed it and I think if anything I would give it a lower figure, but not of any great amount.

Q. I see. Mr. Paine, what, in your opinion, is the fair market value of the oil royalty interests of the Carson Estate Company?

A. \$283,000.00.

Q. Now, Mr. Paine, have you also made an appraisal of the stock of the Dominguez Estate Company?

A. As of that date, yes. [218]

Q. As that date; that is what I mean; as of June 5, 1941.

A. Yes; \$420.00.

Q. What did you take into consideration in arriving at that value?

A. I took into consideration your stipulation with respect to other assets.

Q. Stipulation and the exhibits, you mean?

A. Yes. And my appraisal of the value of the oil properties. And I also took into account the earnings record of the company.

Q. Mr. Paine, the stipulation and the exhibits, particularly the exhibits attached to the stipulation show the balance sheets and profit and loss state-

(Testimony of Paul Paine.)

ments for a number of years of the Dominguez Estate Company, and as well its dividend record and earnings and what not. You took those into consideration; did you not? A. Yes.

Q. Well, how did you arrive at the value you said that you gave for the Dominguez Estate Company stock?

A. I followed two courses. First, I reconstructed me a balance sheet of my own. And second. I made a study of the earnings of the company and arrived at two estimates. And I took the average of these two.

Now, first as to the balance sheet, I arrived at [219] the value per share of this company, based upon the balance sheet record of a current asset. I rated those as having a value of 90 per cent of the balance sheet statement.

The Court: Pardon the interruption. What is the balance? Is it in these exhibits? Which one is it?

Mr. Mackay: I think it is——

Mr. Melville: 1-R.

The Witness: And I arrived at a value per share for each of these elements in the balance sheet. First, the current assets, which I rated at 90 per cent. And that divided by the outstanding shares, 10,499, equals \$74.00.

The stocks and bonds I rated at 70 per cent; equivalent to \$76.00 per share. The ranch real estate I rated at 40 per cent, which is equivalent to \$62.00 per share. And the other real estate at

(Testimony of Paul Paine.)

50 per cent, equivalent to \$78.00 per share.

The oil property, I went back to the analytical appraisal of the discounted present worth of future earnings at 5 per cent; equal to \$6,218,349.00.

The Court: Pardon the interruption.

The Witness: Yes, indeed.

The Court: I am not sure I understand what you mean by taking stock and bonds, ranch real estate and so on at 50 per cent.

The Witness: I am sorry.

The Court: What figure do you mean, of the book [220] values or of the stipulated fair market value?

The Witness: The stipulated fair market value of stocks and bonds is set down here as \$1,141,270.00.

The Court: You took 70——

The Witness: I take 70 per cent of that.

Mr. Melville: Your Honor, the stipulation of the parties is that this is the fair market value.

The Court: I know. He is telling how he analyzed it. That is the reason I was trying to follow them.

The Witness: Should I follow what counsel——

The Court: You let counsel inquire. He may cross examine you a little bit.

The Witness: At 70 per cent, that equals \$798,748.00, divided by the outstanding stock which is equivalent to \$76.00 a share. The oil property on a 5 per cent discount factor, applied to your agreed future earnings, equals \$6,219,349.00. I assumed there would be a further 25 per cent provision to

(Testimony of Paul Paine.)

come out of that, to meet the State and Federal income taxes. This reduces it to \$4,664,412.00, which per share for the 10,499 shares would equal \$444.00.

Now, it has been my experience in situations of this kind that these appraisals, when put in terms of stock of a company which owns the property, are found to be from $2\frac{1}{2}$ to 4 times what the stock actually sells for. And I used particularly here as an index a transaction which had happened [221] not long before then as to the Dominguez Oil Fields Company, a corporation, where a similar issuance of stock showed the stock to go out on a basis of $2\frac{1}{4}$ or $2\frac{1}{2}$ to one.

So I applied a 50 per cent reduction to that, making the stock of the company, on my balance sheet, \$222.00 for its oil interests. Now, the total of the interest outside of the oil would be \$290.00. I reduced that by 10 per cent to cover what would be the cost of distributing that stock and bringing it out into the open and making a market for it. That leaves the stock value per share for all the interests, aside from oil, \$261.00, added to \$222.00, equals \$483.00; against which there were liabilities equivalent to \$28.00, leaving a net value per share of \$455.00. That is one way of considering the value of that stock.

A second way is to consider the earnings of the stock and how that would be reflected in its market value, because we are able to compare this with other somewhat comparable companies and the way those stocks were behaving at that time.

(Testimony of Paul Paine.)

Now, the earnings of the company before depletion for 1940 was \$47.80. And the earnings for the company in 1941 were \$47.91 per share. So I assumed that the investor would take \$48.00 per share as the annual earnings; multiply it by eight times to ascertain his measure of the value of that stock, which equals \$384.00 per share. [222]

I then took the average of \$384.00 and of \$455.00, which is \$419.50, and called it \$420.00 a share.

Q. Is that your estimate of the fair market value?

A. That is my estimate of the fair market value of the stock at this time.

Q. You mentioned, I think, Mr. Paine, that the Dominguez Oil Fields Company—will you tell the Court what that is and what transaction you are referring to?

A. That is an entirely separate company, has no relation to the Dominguez Estate Company. It is a lessee or operating oil company which owns along with the Union Oil Company a half interest in the lessee position on the three properties which adjoin this Reyes lease.

In the Reyes lease it owns a smaller interest, along with the Union and the Shell. Late in 1938, I think it was, the Mills Estate disposed of a lot of that stock. I was hired by the underwriting group to make an appraisal of it, and to advise them in the course of the financing.

I found at that time that my estimate of the future profits which that company was going to

(Testimony of Paul Paine.)

obtain per share was equivalent to \$100.00 per share. And that discounted on a 6 per cent pattern over the future was equivalent to about \$65.00 per share. In other words, if the income tax didn't change and if the price of oil continued the same and the costs continued in the pattern which I had made, why, the person who [223] paid for a share of the stock could expect to see \$100.00 of profits and earnings come into the company throughout its history per share.

And that discounted at 6 per cent over this period and at the anticipated rate of return, that is equivalent to \$65.00 per share. That stock was actually sold by the Mills Estate to the underwriting group for \$32.50 and redistributed by the broker for \$36.00 per share. The brokers were Dean Witter, Smith, Barney, Leahman Bros., and one or two more. That is what you are asking about?

Q. Yes, Mr. Paine. Now, did you also make a valuation or an appraisal of the stock of the Francis Land Company?

A. Well, I can relate that in a short time. I think Francis was worth just as much as Dominguez and no more. In theory there is 10 per cent difference there. One could come to the conclusion that Francis' stock, by reason of its holding in Dominguez—you see, ownership of stock in Dominguez Estate Company is almost the only asset that Francis had. But when that stock reaches the market it would be my opinion it would sell for no more than the Dominguez, because it is further removed

(Testimony of Paul Paine.)

from its source of revenue, which is entirely the income, or almost entirely the income of Dominguez.

Q. When you got dividends it could be subject to tax to a 15 per cent of the dividends, so that would further reduce its value, wouldn't it, Mr. Paine? [224]

A. It would reduce its income relatively, yes.

Q. That is what I mean.

A. Yes. When you get to taking——

The Court: I am a little hazy here as to what Francis has. Francis owns half of Dominguez stock; is that right?

Mr. Mackay: Francis owns 5,499 shares out of 10,499.

The Witness: A little over half.

The Court: You say the Francis stock is worth exactly the same as the Dominguez stock. Do you mean that on a prorata basis or what?

The Witness: Per share.

The Court: Per share?

The Witness: Yes. What Francis had was had outstanding 5000 shares of stock. And it owned 5,499 shares of Dominguez. So far each share of Francis you would own 1-1/10th shares of Dominguez. Am I correct?

Mr. Mackay: That is right.

Mr. Melville: That is right.

Mr. Mackay: Your Honor, please, could we take a recess?

The Court: Yes. We will suspend at this time for a brief recess.

(Testimony of Paul Paine.)

(A short recess was taken.) [225]

Mr. Mackay: You may cross examine.

Mr. Melville: Do you want to make a stipulation at this time?

Mr. Mackay: Yes. Your Honor, please, in order to shorten the time of the trial, the parties have agreed to stipulate that the fair market value on June 5, 1941, of the royalty interest of Carson Estate is \$285,000.00.

Mr. Melville: It is so stipulated, your Honor.

The Court: In your exhibits, what figures does that take the place of?

Mr. Melville: That was left blank. That was at issue, one of the questions we are trying to prove, 3 (c).

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

The substance of your stipulation, gentlemen, is that on Joint Exhibit 3-C the fifth item, following oil properties, which shows on the exhibit as at issue, you now substitute the amount which you have?

Mr. Mackay: That is quite all right.

Mr. Melville: That is correct, your Honor.

The Witness: What was that amount again?

Mr. Mackay: \$285,000.00.

The Court: Is there any objection to my putting that into the exhibit? [226]

Mr. Melville: I think it would be advisable, your Honor.

(Testimony of Paul Paine.)

Mr. Mackay: I think it would be advisable, your Honor.

The Court: Very well. \$285,000.00. All right. Thank you, gentlemen.

Mr. Mackay: You may cross examine the witness?

Cross Examination

By Mr. Melville:

Q. Mr. Paine, what is fair market value?

A. That is a legal term. I do not know what it is. I am guided in my own estimates. My use of the term in my work, I accept as fair market value my estimate or opinion of the meeting ground at the specific date of a buyer, who is willing and able to buy, and a seller, who desires to sell, but is not forced to do so; with both of these having full knowledge of the facts.

Now, I am sorry not to respond to your question. I am not a lawyer. I can't answer it. It is exclusively a legal term.

Q. Do you consider it to be a legal absurdity?

A. Not completely. I think many of these legal efforts to fit one definition to a great many circumstances leads into situations which approach the absurd. No, this conception of the meeting ground of these two persons of that date is [227] far from absurd. If I understand what you mean by absurd.

Q. My question wasn't as to your application of fair market value to the facts in this case, or you use of it in this case, but I am just wondering if

(Testimony of Paul Paine.)

you don't fundamentally believe that fair market value is a legal absurdity?

A. I wouldn't go that far, no.

Q. You never went that far?

A. No, I wouldn't say I went that far; oh, no.

Q. Mr. Paine, have you ever written a book?

A. "Would that my enemy would write a book."

I have written two books; one on the drilling of oil wells and the technical methods of producing oil, and the second book on the subject of the valuation of oil properties.

Q. Is this the book you wrote, Mr. Paine (indicating)?

A. Yes.

Q. When did you write that?

A. That was along in '41, '42.

Q. Just about the period we are dealing with?

A. Yes; a little bit later, I think.

Q. How much later?

A. Not over a year later.

Mr. Mackay: I think it says 1942.

The Witness: August 19, '42.

By Mr. Melville:

Q. That is when it was published. When was it written? [228]

A. In the year preceding that.

Q. 1941?

A. And it was spread out: Now, I wrote various papers at one time and another, and then one day I sat me down and wrote an article on the subject of fair market value. And then I thought, "Why

(Testimony of Paul Paine.)

take a lot of bites at this apple? Why don't you write a book?" So I did.

Q. Would you like to tell the Court what you think about fair market value and what you said about it in your book?

A. No, I wouldn't like to.

Q. Supposing you do it, anyway.

A. There are a great many references. Sit back and relax, because it is going to take many pages.

The Court: I don't believe I want the witness to read the book to me.

Mr. Melville: Was that on the record, your Honor?

The Court: Yes. I am serious about that. If there is something in the book your particularly want in evidence, perhaps we may get it in some way besides having it read into the record.

Mr. Melville: Well, I have in mind, your Honor, what this particular witness said in his book on pages 165 and 172 with respect to fair market value.

The Court: Well, I think the book has now been [229] identified. I think you may yourself read in whatever you wish.

Mr. Melville: Thank you, your Honor.

The Court: I would like to have you make it brief because I don't see any point in having a lot of it in here.

By Mr. Melville:

Q. You may follow me to make sure I quote you correctly.

"Fair market value is exclusively——"

(Testimony of Paul Paine.)

Mr. Mackay: Pardon me. Will you give me the page?

Mr. Melville: 165.

The Witness: Do you want this (indicating)?

Mr. Mackay: No, you keep it.

The Witness: I have a copy here. I knew he would drag it out.

Mr. Melville: Page 165, Mr. Mackay.

Mr. Mackay: That you, Colonel.

By Mr. Melville:

Q. "Fair market value is exclusively a legal term; its origin is in the law and there is its field. It is a synthetic expression and traditionally has come to mean that amount which would be paid at a specific time by a buyer, able and willing to buy, and accepted by a seller, willing but not forced to sell, with both buyer and seller having a reasonable knowledge [230] of the facts. The basis is, therefore, an assumption of a hypothetical trade or deal between an imaginary seller and an imaginary seller and an imaginary buyer. Unhappily the Courts in their usual endeavor to fit a single yardstick to many widely different conditions have failed to keep up with progress in the art of valuation by improving the legal technique or by clarifying the inconsistencies of decisions. Conflicts of decisions in the various jurisdictions are completely bewildering, and for this reason a valuation relating to fair market value must be predicated as to its nature and limitations upon a full definition from legal counsel."

(Testimony of Paul Paine.)

On page 167, the first full paragraph:

“Market price should not be confused with fair market value.”

Also, on the same page, “It is apparent, therefore, that the estimate of fair market value must rely upon a series of conceptions, all of which are hypothetical, as to what these fictional characters—the willing seller and the willing buyer—would do at a given time and place.”

Mr. Mackay: If your Honor please, I don’t want to interrupt the cross examination, but it is going to be awfully hard to follow this if he is going to read through a couple of hundred pages; a little bit here and a little bit [231] there, and examine on the whole thing.

The Court: He is apparently about through.

The Witness: I think this is good.

Mr. Melville: On this particular point I am, your Honor, on page 171, toward the end of that paragraph at the top:

“To a realist it is all very absurd; but it is the law, and it can be made intriguing and interesting if one brings himself and his reasoning processes playfully to array the buyer and the seller in a series of imaginative negotiations.”

And on page 172, the last paragraph before the references:

“Thus, fair market value is unique and is still undefined.”

(Testimony of Paul Paine.)

By Mr. Nelville:

Q. Now, Mr. Paine, passing——

A. May I answer your questions? I take it this reading takes the form of a question. I would like to answer it.

The Court: I take it now, so far, I think, he is about to ask you a question. Is that right, Mr. Melville?

Mr. Melville: I was about to leave fair market value, in view of what the Court has said. Perhaps I should ask a question.

The Court: If you have any questions, I will [232] permit you to ask him. If you do not and he cares to make any statement at this juncture, he will be permitted to do so.

By Mr. Melville:

Q. I have quoted you correctly, have I not, Mr. Paine?

A. Yes, except in this respect: That you have picked out selected sentences, without putting, embodying the context along that; and to that extend it has been quite misleading in places.

Q. Did I say anything you did not write or did not believe, or do not believe?

A. What you have erred in is by way of what you left out. You have unfairly quoted specific sentences, without giving the rest of the material. You know what I am talking about; except in that respect you have quoted this correctly.

Q. I don't want to be unfair about this, Mr. Paine.

(Testimony of Paul Paine.)

A. I don't think you do. I think you haven't understood how unfair you are.

Q. If I have left out anything you think ought to be added, you may do so, do so at this time.

A. It won't take me long.

The Court: You may proceed.

The Witness: The reference to a realist, it is all very absurd, refers very definitely to some material right ahead of it. You didn't read that, which would take the sting out of it as far as the legal fraternity is concerned. [233]

I don't want to go into this lengthily, but I do think in your first quotation, the quotations referring to page 165, you might well have added that the appraiser—it says here, “The appraiser must be patient and sympathetic. He must remember that, even if the hypothetical conception of the willing buyer and the willing seller is a fiction, it is one that has become established by legal usage and must be followed. The law seems to be fond of hypothetical situations and people; usually they are more tractable and responsive than their real counterparts, especially among the engineers. The shock we receive when we come to learn that we cannot reform our parents is slight compared with the shock to the engineer who attempts to reform court procedure.”

I am serious about this because I feel the engineer must be guided by the law and the work he does, and I endeavor to do that.

The Court: If the engineer had some yardstick

(Testimony of Paul Paine.)

that could be given to use to measure your fair market value in all these cases, we would be happy to receive it.

Mr. Mackay: Do you have any further comments on this?

The Witness: No.

By Mr. Melville:

Q. You also believe, Mr. Paine, don't you, that the work of the engineer has to be made to fit not only the law [234] but interests of his clients?

A. Yes. If his client—it must be interpreted properly. He mustn't necessarily adopt a partison attitude, if that is what you are implying.

Q. I think the book will speak for itself. On page 186 you deal first with fair market value, then present worth and come down to my employer, the Bureau of Internal Revenue.

The Internal Revenue Bureau receives many valuations in matters before this organization. A very complete documentary compilation is welcomed—one might say it is required. There are a few inhibitions as to length or elaborateness.

A. Unless it is shown no estimate based on comparable properties is possible. Engineering studies are in order if made for the purpose of arriving at the ratio of values with properties whose sales' history are none. In actual fact too often the question of values in gift and inheritance tax situations is resolved by parties and negotiations.

The Government reaches into the air and brings down a high figure. The estate of the deceased then

(Testimony of Paul Paine.)

hires experts who turn in a low figure. The two reports are incredibly apart, but finally a middle ground is reached and agreed to by both sides. Probably as reasonably correct an answer as could be reached in any other manner while done—have a correct conclusion obtained through an erroneous line of reasoning. [235]

Q. Do I understand, Mr. Paine, that you are an expert who has been hired by the petitioner in this case to turn in a low figure, to quote your book?

A. No, you don't understand that from anything I have said; and it is not true. That is silly.

Q. You wrote it.

A. Your question is silly, Not what I wrote.

Q. On page 4 under the subject of "Purpose," the first two sentences of that:

"Any concept of the value of a thing and the processes for ascertaining that value are bound to be influenced by the particular purpose for which the appraisal is being carried out. A valuation is never an end in itself, but may be required for any one of many purposes."

In your direct examination, Mr. Paine, you stated you have had experience in making valuations for security loans, for oil companies, with a view to sale, purchase, mergers, and so forth, and also valuations for the Securities and Exchange Commission, the landowner, that is, the lessor, and so forth.

Do I understand correctly from your book that

(Testimony of Paul Paine.)

in making these valuations for these various purposes you use a different method and arrive at a different result?

A. Yes. Frequently valuations made for a loan purpose [236] is directed directly to the question of the capacity of the property to pay the loan. The final ultimate value of the property is not ascertained with any degree of great care.

In other instances, a buyer of an oil property may be a refinery company which seeks a supply of oil. And he says, "I want that oil and I am ready to pay a good full price for it." That is a different purpose. Another purpose may be the ascertaining of market value.

Q. But if in each case you were asked to ascertain the fair market value as of a given date, for various purposes, would you have different answers?

A. Well, let me point out to you, in moving over from this quotation to this question which you now put, you introduce fair market value. If you go back to this excerpt you took out in that connection, I would call your attention to the fact that there is much more material on this subject on page 135 and page 150.

Why, I point out to you that on page 4 it says, "Any concept of the value of a thing—" not the market value. But then here we are talking about the value of a thing. Now, do you wish to introduce the expression "market value" in there or not? If so, then don't rely on the book.

(Testimony of Paul Paine.)

Q. Is it true, Mr. Paine, that the value of a property to a seller differs from its value to a buyer?

A. It may differ quite widely, depending upon the [237] circumstances. I can't answer that specifically unless you describe the seller and the buyer to me. I think it would help you if you read the last paragraph on page 150 on this subject.

Mr. Mackay: You have a right to explain that, Mr. Witness.

The Witness: I say, "Here again is the significance of the purpose for which a valuation is made and an indication of how the one property may be found simultaneously to have different values for different purposes," and so on.

"An engineering appraisal, computed in accordance with the wish of some one whose desire is the immediate investment of surplus income through the agency of drilling oil wells and whose tax position makes that course especially advantageous, may arrive at a value quite different from what is estimated for a company situated so that it is not prepared to advance development expenses and is, in fact, more concerned with early earnings and dividends in its operating and financial program. The meanings of the expression 'value' are very different to these two interests."

I think that is what you are reaching for.

By Mr. Melville:

Q. Mr. Paine, is there any legal complications

(Testimony of Paul Paine.)

involved [238] in making appraisals for the Securities and Exchange Commission, which you don't run into in making appraisals for ordinary clients?

A. Yes.

Q. Explain that, please.

A. The principal thing is that the Securities and Exchange Commission uses the word, not revelation, but something like that—you must reveal all the facts. You must hang all the wash out on the line and reports must be made for the Securities and Exchange Commission, which should be very full and complete in that respect.

But aside from that, the Securities and Exchange Commission gives one a great freedom in preparing it, the material.

Q. Is there any penal provisions in the event that you render an erroneous or false report?

Mr. Mackay: If your Honor please——

The Court: I wonder if we are not going afield. I have permitted you to go much further with excerpts both from the standpoint of the petitioner and the witness, and from the standpoint of the counsel for the Government, than is material to this case, of the reading from this book.

Yet I think it will soon begin to hold you down to general rules of cross-examination. I am not sure in going into the Securities and Exchange Commission, that it has much [239] to do with it.

We are dealing here with fair market value upon a basic date. The witness apparently understands what is meant by fair market value, from the law

(Testimony of Paul Paine.)

standpoint, and has attempted to give us his idea of fair market value. I would like to have your cross-examination limited, as nearly as you can, to testimony which the witness has given. Yet I don't wish to foreclose you from any proper cross-examination.

By Mr. Melville:

Q. Mr. Paine, at one point in your testimony you referred to using the price of 40 cents per barrel in making your estimates. Would you explain that, please, how you arrived at that 40 cents a barrel? [240]

A. Well, I compared it with transactions which I have observed from time to time that were actually made and their equivalent per barrel as those transactions were made; particularly this one of the Dominguez Oil Fields Company, in which the price at which that stock went out was equivalent to 31 cents per barrel in the ground.

This royalty was worth more money in the ground than the Dominguez Oil Fields Company's interest because the Dominguez Oil Field has to pay as a lessee the operating expenses, whereas the royalty comes to the Dominguez Estate Company almost clear of any contribution toward the development or the operations.

Other trades have been made in which the price—the equivalent value per barrel in the ground would range from 70 cents or more clear down to 15 cents. This 40 is my idea of what was a proper price for this.

(Testimony of Paul Paine.)

Q. In other words, it is your understanding that the parties have not agreed upon the probable future price of oil in this case?

A. I know nothing about that. I am considering just what would have been the view of the seller and the buyer at that date.

Q. And you took your own figure of 40 cents a barrel, rather than any figure that the parties may have agreed to? A. Oh, yes. [241]

Q. If the record should show that the parties had agreed to use specific prices for the future oil to be produced, with respect to various leases, would that change your testimony?

A. Wait a minute.

Mr. Mackay: Just a moment. I object to that, if your Honor please. The record is quite clear on that. We have stipulated, if your Honor please, the oil reserves, we have stipulated the probable future production.

The Court: I think his 40 cents a barrel that he is talking about it an entirely different item than the \$1.15 a barrel, or whatever it was, you stipulated in the probable selling price.

Mr. Melville: That is what I want to clear up. I am not clear yet.

The Witness: My 40 cents is my estimate, what the buyer and seller considered that oil to be worth in the ground, if your stipulation was the equivalent of an expected return of \$1.13 per barrel over the life of the property.

(Testimony of Paul Paine.)

By Mr. Melville:

Q. A barrel of oil is worth more to the lessor than it is to the lessee; is it not?

A. Generally it is worth more to the lessee than it is to the lessor because the lessee uses it in his pipeline and refining and marketing operations.

Q. Who bears the cost of lifting it?

A. The lessee.

Q. What does that cost of lifting usually run to per barrel?

A. It will vary from a few cents up to a large amount.

Q. How much?

A. Let me say—referring to your question which was what a barrel of oil was worth in the ground. Did you mean in the ground?

A. No, I meant at the surface.

A. No, it is worth more to the lessee than it is to the lessor.

Q. How about it in the ground?

A. Then it is worth more to the lessor than the lessee because the lessee must pay the cost of lifting, and the cost of lifting averages on this property—I wouldn't know precisely, but I would say it would be somewhere around 15 or 18 cents per barrel, or something of that order of magnitude, not including federal and state income taxes.

Q. Do you have any opinion as to what it costs to develop a barrel of oil, that is, discover the oil in the ground? A. Yes.

Q. About how much would you say here in Southern California? [243]

(Testimony of Paul Paine.)

A. It would have to be a wild guess, but I would say probably it costs 25, 30 cents. Now, I am answering your question which was to discover a barrel of oil in the ground. That does not include the cost of acquisition, development production.

Q. Now, frankly, Mr. Paine, I am referring to the report which you also referred to in your book, made by the Chase National Bank of New York City, as to the sources, disposition, characteristics of the capital employed by 30 oil companies.

A. Where is the reference in my book to that? Look at your date on that; a couple of years after my book.

Q. I stand corrected. This particular one was subsequent to your book.

A. Joe Poke didn't write that until a long time after.

Q. Didn't they write other analyses of this general subject? A. I think so.

Q. I just wanted to tell you what I had in mind, so it might help you answer my questions.

Now, you have answered the question as to discovery but qualified it by saying it didn't include other things.

A. No, I haven't qualified it. I pointed out to you, I answered your question about what it cost to discover the oil; that is, the exploration. [244]

Q. That is how much?

A. My estimate of 25 cents is just a wild guess. I rebel at being called to express it, it can vary so widely.

(Testimony of Paul Paine.)

We have that question of whether it is cheaper to buy oil that somebody else has found, or go out with a lot of geologists and expense accounts and try to find it yourself. No two companies have the same experience. Some companies—I don't want to make a speech.

Mr. Mackay: You have a right to explain.

The Witness: Some companies are characterized by having a large number of geologists, and they find it cheaply, but they buy it advantageously. A question of this kind is almost impossible to run down and get a figure on because the companies will not reveal them; others buy it advantageously.

By Mr. Melville:

Q. In making your valuation in this case, Mr. Paine, did you do so on the basis of value per barrel of daily oil production?

A. That was one of the courses I followed.

Q. Is that one you recognize as being——

A. Oh, yes. It isn't a primary one. It is one we use largely for checking others and for checking the merits of other properties. But it is one that is used professionally constantly by dealers.

Q. Would you explain—I am referring now to page 155 [245] of your book, the middle of the page, wherein you say:

“The method and the measure——”

This is on the subject, incidentally, of the daily barrel——

“——lack precision and have no direct field in finished valuation practice.”

(Testimony of Paul Paine.)

Would you explain that, in the light of your previous answer?

A. By finished valuation I mean these engineering and analytical appraisals, which work out each on the right-hand side of the decimal point. Is that clear?

Q. Not exactly. Did you make a finished analytical appraisal in this case? A. Yes.

Q. So that this, in your opinion, this method has no direct field or has no application, as I understand it, then, to a finished analytical appraisal.

A. You are mixing up apples and cranberries, Mister. You can't use this method in an analytical appraisal. Understand analytical or engineering appraisal is one derived of an estimate of the present worth of the future profits.

Mr. Mackay: An appraisal by this method is a different method of appraisal. You are not going to use one for the purpose of accomplishing the other, which I understand your question to be. [246]

By Mr. Melville:

Q. What method did you use in this case then?

A. In my appraisal of the market value?

Q. Yes.

A. I used the method of making all these appraisals, wrapping them up and looking them over and weighing them and arriving at my estimate. Market value must be an estimate. It can't be a precise meticulous mathematically derived figure. It has to be an estimate. It is based on the conception of a transaction which did not take place be-

(Testimony of Paul Paine.)

tween two persons who do not exist.

Q. Is the pay-out method a recognized means of valuation? A. Yes.

Q. Do you use that in this case?

A. Yes, I testified that.

Q. What value did you get on the pay-out? How many years pay-out did you use?

A. Four years and five years. The value at five years was \$3,134,620.00. And at four years was \$2,504,896.00.

Q. You are generally familiar with the oil properties that we are appraising here?

A. I think I am, yes, except some of these isolated small properties.

Q. The Reyes lease?

A. The Reyes and the Carson-Union. [247]

Q. Mighty good lease; isn't it?

A. Splendid property and well operated.

Q. Do you know of any properties in Southern California that are any better? A. Yes.

Q. Would you classify it as one of the best?

A. It is a very good property; no question about that.

Q. One of the best?

A. I would almost go that far with you, yes. It isn't one of the best. It wasn't one of the best on this date because those Miocene wells were beginning to show very high gas and oil rate. At this date it was wondered how far that Miocene sand was going to go.

(Testimony of Paul Paine.)

Q. Would you say the Reyes lease was settled production?

A. I am sorry. I will have to ask you to define the "settled production." The reason for that is that settled production is used very sloppy, especially by attorneys. I will endeavor to answer your question if you will tell me what settled production is. I don't know. I am not trying to avoid your question. You tell me what you mean by settled production.

Q. I was just quoting from your book, so I will read the part that I had reference to. Page 151, under "Payout Method," the second paragraph there ends with this sentence: [248]

"The payout period in transactions of developed oil properties has generally ranged for working interests from four to seven times the annual earnings. Many dealings in royalty interests under wells which are settled and severely curtailed have been transacted for as much as twelve times the annual rate of return."

Now, Mr. Paine, in view of that statement in your book, wherein you state that from four to seven times and in some cases as much as 12 times, why do you use such a low period in valuing the oil royalties in this case?

A. First let me refer you to page 41 which says:

"Settled production is an expression which has many interpretations. It is applied to the

(Testimony of Paul Paine.)

yield of a well or of a property. To the layman it can be seriously misleading if he accepts it to mean a productivity rate which has ceased to change or a decline that has come to rest."

It goes on. It will tell you about what settled production means.

Now, the 12 times the annual rate of return referred specifically to those properties which are very severely curtailed; the West Texas Oil Field properties which had [249] tremendous capacity to produce and yet were having their oil withdrawn at very low rates.

Now, the lower rates would all be a function of how one views it and how one feels about its trading range.

No small element in all of these situations is the income tax outlook and the occasion, the feeling of one that the return is not going to be as great as he might infer from a study of the figures without some consideration of his tax position.

Q. That concludes your answer?

A. Yes, sir.

Q. What I am trying to get at, Mr. Paine, is this: You have testified that the value of oil in the ground is greater to the lessor than to the lessee. Is that correct?

A. A barrel of oil in the ground generally is.

Q. And your book says that from four to seven years pay-out for the lessee; doesn't it?

(Testimony of Paul Paine.)

A. Yes, in some instances. I don't think it lays it down as a fixed rule.

Q. That is a broad range, four to seven?

A. Not in the oil business, no.

Q. Then you go up to 12, which you explain what fields the 12 would apply to. Would the 12 apply to the Reyes lease? A. No. [250]

Q. If four to seven is the proper years to apply to the lessee, what would be the years to apply for the lessor interests.

A. It all depends on the circumstances. Describe the property to me.

Q. Reyes.

A. There wouldn't be much difference there because it isn't severely curtailed. As a matter of fact, a lot of that oil in the Reyes lease is more valuable to the lessee than it is to the lessor, because they take oil right over to their refinery, run it through, market it, distribute it.

Q. Didn't your testimony earlier this afternoon establish that in your opinion oil in the ground was of more value to the lessor than to the lessee?

A. I think that generally is the case.

Q. Isn't that true in the Reyes lease?

A. I don't know, because I don't know what the value of that—let me finish my answer. Relax. I don't know what the value of that oil is to the Shell Company or to the Union Oil Company, as far as its ultimate worth and what they are able to do with it. Whereas, the landowner gets his cash settlement from the company.

(Testimony of Paul Paine.)

Q. Well, it is certainly worth as much to the lessor as it is to the lessee; isn't it?

A. Is this in the ground or at the surface? [251]

Q. In the ground. That is where the oil still is we are valuing here.

A. Yes. It would be the difference—the difference would be academic. I can't be responsive more thoroughly to it than that.

Q. Tell us, Mr. Paine, since in your book you said four to seven years was proper for the lessee and since you now state that the lessor's interest was just as valuable, why do you use the minimum of four rather than the maximum of seven, in view of your testimony that the Reyes lease was one of the best?

A. I don't know why, as far as the book is concerned. I can't answer for how I was feeling about it at the time of the book. Let's leave it there. I don't certify to you that every statement in the book is correct. The book, in some places in the book I speak about royalty oil or oil in the ground being worth nearly always 50 cents a barrel. As a matter of fact, there have been widespread deviations from that. In instances in 1934 oil in the ground in Santa Maria was selling to the basis of about 14 cents a barrel in the ground.

Q. We are talking about 1941, Mr. Paine, the year in which you wrote this book. This is what you say on page 110:

“The cost of finding and buying lessee oil

(Testimony of Paul Paine.)

of good quality in the [252] ground which has been discovered by another person is greater than 40 cents."

You haven't changed your mind about that?

A. I don't say that is an inflexible rule that follows in every instance. As I say, I know of instances where oil has sold in the ground for 14 cents or 15 cents.

Q. Well, let me just read one more paragraph from this same subject matter on page 111:

"Oil in the ground which is proved up but not drilled up is, therefore, a unit of commerce. As such, it engages the attention of the appraiser and is found to sell for as much as 50 cents or more per barrel, depending on quality, crude prices, costs, and other factors. Almost any crude for which there is a market and which can be profitably obtained is fairly worth 10 cents per barrel in the ground."

Do you have an opinion at this time as to how much the oil in the Reyes lease was worth in the ground in 1941?

A. To the lessor?

Q. Yes. A. 40 cents a barrel.

Q. Is that the figure on which you base your appraisal? [253]

A. Yes.

Q. You consider oil royalty as a good investment?

A. Good oil royalties are a very good investment.

(Testimony of Paul Paine.)

Q. We are talking about good oil royalties in this case.

A. You are doing the talking. These are very good oil royalties; it is a splendid investment.

Q. You think this is a splendid investment?

A. Yes.

Q. You consider it a good hedge against inflation?

A. I haven't been much of a believer in inflation and I haven't leaned toward getting much of a hedge. There is probably a hedge, but investors think so more than I do.

Q. You said something in your direct examination about the factors you took into consideration in valuing the stock of the Dominguez Estate Company. Did I understand you to say that one of the factors or one of the reasons why you applied a certain discount was the cost of making a market for it?

A. The cost, the difference that is reflected in getting the stock out into the investment channels, going through the financial houses and generally that is not less than 10 per cent.

Q. Now, Mr. Paine, if a given stock, let's say Chesapeake & Ohio, today sells over the New York Stock [254] Exchange at \$58.00 a share, does that, in your opinion, establish the fair market value?

A. If it is being traded in at \$58.00 a share I would think that is the fair market value.

Q. Supposing there was 1,000 shares sold today, at one figure and one figure only, \$58.00 a share,

(Testimony of Paul Paine.)

would that, in your opinion, establish that \$58.00 is the fair market value of Chesapeake & Ohio?

A. That would be my opinion, yes.

Q. How about the broker's commission that would have to be paid by the seller and the buyer?

A. Each one of those goes, each on one side of that \$58.00.

Q. That is my point. Therefore, why did you take the discount to cover the making of a market?

A. Because this stock is unknown. It has no market. It wasn't listed. It wasn't traded. You are comparing a stock that was established on the trade that was listed, that was being dealt in. Now, you don't move a stock that is in a hermit company. That is unknown. That has no market. You don't move that out into the listing and the stock exchanges without some expense.

Q. Would it surprise you to know there was a ready market for this stock?

A. Yes,—not that there is a ready market for this [255] stock, but you would have to name the price for me. There is a ready market for any stock. There is always somebody up on the third floor of these buildings that will buy these stocks, but you have to put the price right.

Mr. Melville: No more questions.

Mr. Mackay: That is all, Mr. Paine.

(Witness excused.)

The Court: We will suspend for a brief recess.

(Short recess taken.)

Mr. Mackay: I will call Mr. Lovelace.

JONATHAN B. LOVELACE,

called as a witness for and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Will you give your full name for the record?

The Witness: Jonathan B. Lovelace.

By Mr. Mackay:

Q. What is your address, Mr. Lovelace?

A. 650 South Spring Street, Los Angeles.

Q. What is your business?

A. Investment research and investment management.

Q. Mr. Lovelace, will you start with your education [256] and briefly sketch your career up to the present date?

A. I was graduated in 1913 from the Alabama Polytechnic Institute, with a degree of bachelor of science and engineering. I took the Master's Degree the following year and remained there as instructor through the summer of 1917.

In 1917 I entered the Officers' Training Camp and on graduation was commissioned second lieutenant and volunteered for service in France.

I went to France in December, 1917, and served throughout the war in the anti-aircraft artillery, ending up as a captain at the end of that service.

(Testimony of Jonathan B. Lovelace.)

Early in 1919 I returned to the United States and I entered the employ of E. E. MacCrone & Company, Detroit, Michigan, who were members of the New York Stock Exchange. I remained with that firm until the fall of 1929. My work at the outset was as statistician and analyst, and subsequently I became head of the underwriting department and in charge of the company's investments.

I became a partner in 1924, and as a partner had a voice in passing upon underwritings, negotiations of underwritings, and the management of investment funds of the firm and of an investment trust which represented funds of a number of small investors consolidated into one investment trust, which the firm sponsored.

In the summer of 1929 we had a disagreement between [257] the partners as to our policy with respect to our common stock holdings. I favored the sale of stocks and when my views were not followed I determined to withdraw from the firm in order to cash in on the values which then obtained. I gave notice of withdrawal in September, 1929, and the following year I move to California.

In 1931 I was asked by a group of businessmen in Los Angeles, who were then the directors of two local investment companies, namely, American Capital Corporation and the Pacific Investing Corporation, to organize a research group to analyze and recommend investments for the portfolios of those two companies.

I formed such a company under the name of

(Testimony of Jonathan B. Lovelace.)

Capital Research Company, and subsequently I became chairman of the investment committees of the law investment trusts referred to.

In August, 1932, I was made chairman of the investment committees, with primary responsibility for the management of the funds of the two companies, the Pacific Investing Corporation having become Pacific Southern Investors, Inc., through merger in early 1932 with Southern Bond & Share Corporation.

Since August, 1932, I have continued to direct the work of the Capital Research Company and to supervise the buying and selling of securities for these two investment [258] companies in my capacity as chairman of the investment committees, with primary responsibility for portfolio management.

Late in 1932 I was requested to assume the presidency of the Investment Company of America, a common law trust which was under the management of a trustee corporation directed by members of the firm of E. E. MacCrone & Company, from which I had retired in September, 1929. I assumed the presidency of the trust and also the presidency of the management corporation which supervised the portfolio of the trust.

The Investment Company of America was converted into a corporation in December, 1933, and I have since continued as president of the Investment Company under a management contract. I have since continued as president of the Invest-

(Testimony of Jonathan B. Lovelace.)

ment Company of America and as president of the company which manages the funds of that company under a management contract.

My present activities are those of president of the Capital Research Company and of Capital Research and Management Company, chairman of the Investment Committee of Pacific-American Investors, Inc., and president of the Investment Company of America.

In addition to my work in this investment field, I am now, and have been for several years, a director of the [259] following corporations: Pacific Indemnity Company, Pacific Finance Corporation, Automobile Finance Company, Barker Bros., leading house furnishings company. In addition I am a trustee and a member of the executive committee of the Southwest Museum, and a member of the finance committee of the Huntington Memorial Hospital, institutions having endowment funds administered by their respective trustees.

Q. Now, going back to your experience in Detroit, you mentioned underwriting. Will you please tell us what was the nature of your underwriting experience? Name some of the companies that you handled.

A. I made the analysis to determine the public offering price and the underwriting price of the common stocks of several corporations. Those coming first to mind being the Seagrave Corporation, which is engaged in the manufacture of fire-fighting apparatus; the Holland Furnace Com-

(Testimony of Jonathan B. Lovelace.)

pany, which manufactures warm air furnaces and heating equipment; and Mead Johnson Corporation, which manufactures food products for infants and children.

Shares of these companies were successfully marketed, the first two being traded in now on the New York Stock Exchange and the latter on the New York curb market. These are the companies in which I had the primary responsibility for the analyss of the company and the negotiations for underwriting, but I participated as a member [260] of the firm in decisions in respect to a number of other companies whose common stocks subsequently were and now are being traded on the principal exchanges of the country.

Q. Now, in connection with your work with that firm in Detroit, did you have charge of any investment funds, purchases and sales of stock? I think you have already testified regarding one investment trust.

A. Aside from the company's own holdings, the principal fund which we managed was that of the Investment Company of America, the investment trust which I referred to above. The firm had a number of individual clients of considerable wealth with whom we advised as to the purchase and sale of common stocks, but this work was more of an investment counsel nature, rather than a direct management.

Did you personally have charge of that work in the firm?

A. Yes, I was manager of the investment re-

(Testimony of Jonathan B. Lovelace.)

search and management department and responsible to the partnership for that branch of the work.

Q. Now, in connection with that work, what was your method of approach and the type of activity carried on?

A. The object of our research and management department was to keep the funds of the investors at work in common stocks which were considered to have the greatest promise with respect to dividends and appreciation. [261]

In developing the background for this work, we organized a staff of economists, statisticians and analysts.

We first made an analysis of the general economic situation, taking into account the political situation, economic conditions and all factors which have a bearing on the future of securities prices. This was for the purpose of determining whether or not conditions were favorable for the purchase or retention of common stocks. Then we analyzed the industries to determine which industries were most favored by prevailing economic conditions. Then we analyzed the individual companies for the purpose of determining which companies within the industries appeared to have the greatest potentialities.

This work involves study of capital structures, appraisal of managements, and so forth. From the reports of this staff, we would determine the individual stocks which should be purchased, those

(Testimony of Jonathan B. Lovelace.)

which should be retained, and those which should be sold.

Q. Now, you have testified in 1931 you became connected with the American Capital Corporation and what is now the Pacific Southern Investors, Inc., and I think you also testified that in August, 1932, you became chairman of the investment committee of each of these companies? A. Yes.

Q. State briefly the nature of your duties and activities in connection with those companies.

A. As chairman of the investment committee of the two companies referred to I was given primary responsibility for the management of their portfolios, and, as background for that work, I had before me the studies of the Capital Research Company, which had been formed for the purpose of supplying the material needed as a background for the determination of investment policy and the selection of individual issues. The Capital Research Company was staffed in much the same manner as that I described for the research organization when I was in Detroit. We retained Dr. Lionel D. Edie as consulting economist, and I secured the services of a number of analysts and statisticians who were carrying on the work of analyzing industries and companies.

The research reports were made available to the investment committee, and in my capacity as chairman, I had authority from the board of directors to determine upon investment policy and to place orders for the purchase and/or sale of securities

(Testimony of Jonathan B. Lovelace.)

held by the two investment companies. Since I was president of the Research Company, as well as chairman of the investment committee, I was continuously working with the research material, and from my studies I made recommendations to them with respect to securities offered and those contemplated for purchase, and these recommendations were usually followed. [263]

Q. I think you also mentioned The Investment Company of America, to which I think you returned late in 1932. A. Yes.

Q. What has been your duties with the corporation or trust since 1932?

A. I had been president of The Investment Company of America over that period. In addition, the president of the Management Corporation. My duties as president of the management company were essentially the same as those of chairman of the investment committees of the two local trusts. I had the major responsibility for supervision of the investment portfolio of The Investment Company of America.

Q. Am I correct in understanding that since 1932 you have had the principal responsibility for the purchase and sale of assets owned by these three investment trusts or companies that you have mentioned? A. Yes.

Q. What are the relative sizes of these companies?

A. Pacific Southern Investors, Inc. and American Capital Corporation were merged in 1943, in

(Testimony of Jonathan B. Lovelace.)

August to a company known as Pacific-American Investors, Inc. The assets of that company at June 30, 1945, were approximately \$15,350,000.00. The assets of the Investment Company of America were approximately \$5,250,000.00.

Q. You say you have had primary responsibility for the [264] management of these three companies since August, 1932. Can you tell us what the operating results have been and something about the method of operation?

A. In the case of Pacific-Southern Investors, Inc. and American Capital Corporation the audited report of Messrs. Haskins & Sells was made to trace the record of the earnings and gains for stockholders of the two companies from August 31, 1932, to December 31, 1942. That showed a total of net income and gain for securityholders of 93.36 per cent for Pacific-Southern Investors, Inc. and 98.71 per cent for American Capital Corporation; an average of 97.53 per cent which is at the rate of 9.4 per cent per annum over this period.

The net assets of the merged company as of December 31, 1942, giving effect to the merger, were \$10,024,000.00 and the net assets of the company as of June 30, 1945, were \$15,372,000.00, an increase for the two and one-half year period of more than 50 per cent, or, in dollars, in excess of \$5,000,000.00; and this gain is after dividend payments for the period exceeding \$1,000,000.00. So that over the 13-year period the annual return has been something like 11 per cent per annum average.

(Testimony of Jonathan B. Lovelace.)

In the case of The Investment Company of America, which is an open end investment trust, the results are published periodically in Barron's Weekly where comparison [265] is made with the results achieved for other like funds.

In its issue of January 29, 1945, Barron's published a table showing the results achieved for shareholders of all of the leading open-end investment companies over a period of years, and inserted a column showing results for the war years, that is, in the period from December 31, 1938, to December 31, 1944, inclusive. In that period they showed the gains for shareholders of The Investment Company of America amounted to 55.9 per cent, the highest of any company, and comparing with an average of 35.6 per cent for all of the companies tabulated.

Q. What are the average number of issues held by each of these companies and what volume of sales or purchases are made on the average for each of these companies during the calendar year?

A. We try to hold between 70 and 90 individual securities to get wide diversification. During the course of a year we may sell as many as 25 or 30 of these issues and we may buy a like number and put the amount of money into a lesser number of securities we feel complete confidence in.

Q. In connection with each of these sales or purchases, what is your method of investigation by way of determining the new issues which you are going to purchase?

(Testimony of Jonathan B. Lovelace.)

A. The staff of analysts is continually studying the outlook for various industries. When we can detect a [266] change for the better in an industry not represented in our portfolio, we then seek to find the strongest company in that industry, the company with the soundest capital structure, the ablest management and most favorably situated, the company having the greatest potentialities in that particular industry. We not only have statistical analysts but men in the field calling on corporations and trying to find out what new products they have and what their plans are for the future. Under certain conditions we might conclude that the public utility industry was faced with such difficulties that we would not care to own any securities in that industry, and buy into some other industry, automobiles or broadcasting that we thought had better prospects over the years ahead.

We are constantly weighing the outlook for various industries and weighing the situation of individual companies, seeing what price the company is selling at in relation to its earning power and its prospects for future earnings.

Q. Mr. Lovelace, have you made an appraisal and formed an opinion as to the fair market value on June 5, 1941, of the Dominguez Estate Company stock?

A. I have.

Q. In doing that are you familiar with the stipulations that have been filed in court, and the exhibits?

A. Yes. [267]

(Testimony of Jonathan B. Lovelace.)

Q. You were given copies of them?

A. I was, yes.

Q. You have made an analysis of it?

A. Yes.

Q. Now, would you please tell the Court what the general market conditions were at June 5, 1941, here in Los Angeles?

A. Yes. In order to refresh my mind as to conditions in June, 1941, I read back through the commercial and financial columns and Moody's Investor Service, to see what they were saying at that time, as a check on my memory.

We had some pretty hectic years. We don't try to remember precisely the conditions at a date like that. I took the Moody's Service which comes out each week and read through their comments, summaries of their comments for May 5, 1941, through to June 9. That is the period just ahead of the date of this appraisal. The issue of May 5th says:

"Sagging prices without any heavy liquidation were seen in last week's stock market. Many stocks touched new lows for 1941 and some fell below their lowest levels of the previous year. No startling news accompanied this market reaction which seemed due to the obvious——"

The Court: I suggest we not read from the reports. You tell us the general conditions of the market. I think it would be better.

The Witness: The condition of the market at the time was one of fear. It was a period in which

(Testimony of Jonathan B. Lovelace.)

developments [268] in Europe were very unfavorable. There was great concern about higher taxes. There was concern as to whether we would get into the war or not, and particularly since May 29th, I believe it was, 1941, the President declared an emergency. I am not sure of the exact title he used. He declared unlimited emergency May, 1941.

The attitude of investors generally was one of uncertainty, and particularly of fear regarding higher taxes, because that was—new tax proposals had been made in May, 1941, all looking toward higher taxes. The Treasury had set the goals of increasing its income from \$12,000,000,000.00 to \$19,000,000,000.00. That forecast was surely higher taxes. Under those circumstances the investors were rather cautious, and as a result you had common stocks selling very low in relation to their assets and earnings.

By Mr. Mackay:

Q. Well now, you stated the common stocks were selling low with respect to their relationship of their assets to their earnings. Can you give us some light on that, as to what stocks you have in mind?

A. Yes. I went through a list of stocks we follow as being interesting companies with interesting prospects, and I listed 50 companies. I might give a few. American Radiator Company, Atlantic Refining, Bethlehem Steel, Borg Warner, Byron Jackson, Chesapeake & Ohio, Chrysler [269] Corporation, Columbia Broadcasting, Commercial Credit,

(Testimony of Jonathan B. Lovelace.)

Commercial Investment Trust, Consolidated Edison, Deere & Company, Douglas Aircraft, Dresser Manufacturing, Electric Auto-Lite, Food Machinery, General Motors, Goodrich, Goodyear Tire & Rubber, Greyhound, Holland Furnace, Kalamazoo Stove, Lambert Chemical, Libby-Owens-Gord—

The Court: Do you want all of these in? I think we have enough.

The Witness: A representative list of stocks. Those stocks were selling June 5, 1941, to yield on the average of 9.6 per cent and were selling at 7.1 per cent times the 1940 earnings, and 8.2 per cent times the 1936 to 1940 average earnings.

Take the same list and eliminate the aircraft and oils and steels as being special situations there, particularly in the steels and aircraft for the very high earnings, because of the war situation, and the average earnings ratio dropped to 7.8 per cent, instead of 8.2 per cent for the 50 stocks; but not any material difference.

Roughly, the common stock of very important companies, all listed on the New York Stock Exchange, were selling at about eight times the net earnings of the preceding five years, and about seven times the earnings of 1940.

Q. Did you make a comparison as to the relationship of the sales price of those stocks to their market value of [270] the assets behind them?

A. I didn't. I did to the oil companies. They were more pertinent to these analyses. They were

(Testimony of Jonathan B. Lovelace.)

selling generally about 45 to 50 per cent of the asset value.

Q. What do you have to say about that? That is, the oil companies? A. Yes.

Q. When you speak of the oil companies, those were the oil companies whose stocks were listed on the various exchanges?

A. I didn't get the question.

Q. When you speak of the oil companies, those were the oil companies whose stocks were listed on the various exchanges?

A. Yes, listed and actively traded on the New York Curb, and New York Stock Exchange, and so forth. In fact, I have several oils in this group, I thought it better as a measuring stick to take the average of a broad list of stocks. Any investor considering the purchase of the Dominguez Estate stock or any other stock would compare it with any other stocks available in the market.

Q. What oil stocks did you take under consideration?

A. I haven't my list here. I notice I didn't place a great deal of weight on that. I took another approach in my appraisal. I can furnish it if you would like to have [271] it.

Q. Now, Mr. Lovelace, taking into consideration the stipulation and the exhibits that have been offered here, and your knowledge of the market conditions at that particular time, will you please tell the court how you arrived—and assuming that the oil royalty of the Dominguez Estate Company

(Testimony of Jonathan B. Lovelace.)

at June 5, 1941, had a fair market value of \$3,000,000.00, will you please tell the court how you arrived at your valuation and what it is?

A. I placed a value on the stock, fair market value on the stock of Dominguez Estate Company as of June 5, 1941, of \$418.00 a share.

Any security, the value of a security, the fair market value is dependent on earning power and on its assets, the ability to earn money over a period of years, the dividends it can pay and the marketability of the investment.

In the case of Dominguez Estate Company, taking the assets at the stipulated figures, and taking the oil property at \$3,000,000.00, a total net asset aggregates \$7,979,699.00. That is a net asset value per share on the 10,499 shares of stock; net as set per share of \$760.04.

The first approach was what you might call an asset approach, as to what would be the value of the stock of a corporation which had a net asset value of \$760.04. In arriving at that you have available in the market certain [272] investment companies, the assets of which are all liquid, and are all computed quarterly and published to investors.

One, for example, is the Lehman Corporation. It has net assets of \$53,000,000.00. The asset value as of March 31, 1941, and as of June 30, 1941, were both published and made public. The difference between the asset value of those two dates was practically nil, practically no difference between

(Testimony of Jonathan B. Lovelace.)

the asset values of investment companies on March 31, 1941, and June 30, 1941.

The Lehman Corporation, for example, had a net asset value which is based on the market value of all the assets it owns. The same way the Dominguez Estate is based on the stipulated values or the fair market value of the individual items Lehman Corporation had an asset value of \$28.58 and was selling at \$20.58. That is a discount of 27.8 per cent.

The National Bond & Share Corporation, which is also listed on the New York Stock Exchange, had an asset value of \$21.07, and a market value of \$14.25, and a discount of 32.4 per cent.

The Consolidated Investment Trust of Boston, which is not listed but traded in Boston had net assets of \$11,900,000.00 and net asset value of \$37.05. Its market price was $22\frac{3}{4}$, a discount of 38.6 per cent.

The Security Company, a Los Angeles company, has total assets of \$5,700,000.00, listed on the Los Angeles [273] Stock Exchange. That company had a net asset value of \$48.30, and stock was selling at $29\frac{1}{2}$; 39 per cent discount.

Shawmut Association, on the Boston Stock Exchange, had net asset value of \$16.16 and was selling at $9\frac{3}{4}$, discount of 39.7 per cent.

Outside of the two stocks listed on the New York Stock Exchange, Lehman and National Bond & Share had an average discount of 30 per cent. We find the discounts in these other securities where the market was more limited approximately

(Testimony of Jonathan B. Lovelace.)

39 per cent, 38.7—38.6 in the case of Consolidated Investment Trust of Boston. 39 per cent in the case of Security Company of Los Angeles, and 39.7 per cent in the case of Shawmut Association. In other words, the less liquidity the shares of the investment company had the greater discount. Generally that is applied or required by investors to invest in that situation.

Taking that approach I felt that if any investor or potential investor were approached with the idea of buying Dominguez Estate Company and was told that this stock had an asset value of \$760.00 a share and he could buy it at a bargain, he would require discount of at least 45 per cent, because he would be buying into a non-liquid personal holding company situation; where he could get 40 per cent by buying into Security Company stock listed on the Los Angeles Stock Exchange. The securities that the Security Company [274] owned were all readily marketable and appraisable. They did have a small amount of real estate, I think about \$400,000.00 of real estate. Generally the assets were liquid and the shares of the company were moderately liquid, inasmuch as they were traded on the Los Angeles Stock Exchange.

I felt an investor would require, as I say, at least a discount of 45 per cent to be interested in the Dominguez Estate Company stock. And that applying the discount of 45 per cent to the net, as set value, we arrive at the figure of \$418.00 a share.

(Testimony of Jonathan B. Lovelace.)

The second approach is to take the earning power of a company and see how this would stack up relatively, on the basis of earning, relative to other companies. I have just said these 50 stocks listed on the New York Stock Exchange were selling at 7.1 times their 1940 earnings. If we apply that ratio to the adjusted earnings of Dominguez Estate we arrive at a valuation of \$215.63.

I might say that in this figure of adjusted earnings I have adjusted the earnings recorded for Dominguez Estate Company by adding back to the earnings the depletion the company charged off in arriving at those earnings, and applying the depletion of 27½ per cent which is the figure used by the government in allowance for depletion charges.

Q. When you say you added it back, you mean the cost depletion shown on the books? [275]

A. Yes. And then subtracted the other to arrive at earnings. On that basis——

Mr. Mackay: If your Honor please, I may state for the record that that exhibit does not show certain amounts of cost depletion on the books. I think that is 4(d).

The Witness: All right. The exhibit referred to there showed there was a depletion of cost of oil, less very nominal figures for recent years, but high figures for the early years because they followed the policy of amortizing on the cost, rather than using a uniform depletion charge.

Taking the figures as stipulated upon, as based on the books of the company, and adjusting for

(Testimony of Jonathan B. Lovelace.)

depletion, we found the earnings of Domínguez to be as follows:

For the year 1932, \$35.07 per share;

For the year 1933, \$30.84 per share.

The Court: Let me ask a question so I might follow you on your adjustment on the depletion. I am not sure I quite understand what you did. That is, for 1932 your depletion of cost is \$413,000.00, is that right? You have the exhibit. I don't wish to confuse you. I am trying to straighten myself out.

The Witness: Yes, that is right.

The Court: You take that out of the income——

The Witness: Add that back to the income.

The Court: Add that back to the income? [276]

The Witness: And then subtracted uniform depletion of 27½ per cent. Let's take the last year and it will be a little easier; take the year 1940.

The Court: All right.

The Witness: In the year 1940 the company showed approximately \$500,000.00—showed \$496,000.00 after the taxes.

Let me go back. The figure there shows the net income before book gain on the sale of real estate of \$488,498.00. You take that figure and add back the \$42,000.00 charged off for depletion and you have a figure of \$501,000.00-plus.

The actual oil royalty in that year was \$665,000.00 up in the income account. That should have been depleted 27½ per cent of uniform depletion charge.

(Testimony of Jonathan B. Lovelace.)

27½ per cent of the oil royalty received amounted to \$183,000.00. Subtracting \$183,000.00 from the figure \$501,000.00 we come out with \$318,018.00 as the adjusted net earnings for the year 1940. That is equivalent to \$30.37. a share.

The effect of this company reporting on a book basis was to overstate the earnings in the latter part of the year. They were making no charge for depletion since they didn't have the property on their books at any capitalizable value, although its value was being depleted. [277]

Mr. Mackay: I might state, for the record, I think it is a fact that this company's depletion got on the books because of certain reorganization back in 1928. And the Commission has not permitted the depletion to be based upon cost. While it is on the books it had to be written off. I think that is the reason why all of the witnesses have added it back, your Honor.

The Witness: The necessity for restating their earnings is clear when you note that in the year 1940 the charge for depletion was only \$42,000.00. Whereas, the company took in \$665,000.00 from its oil property, and at the end—as of June 5, 1941, oil property still had a value of \$3,000,000.00. If that \$3,000,000.00 was put on the books and the life was 14 years and had straight amortization you had to charge off 1/14th of \$3,000,000.00 over the 14 years, which was approximately \$200,000.00 a year.

The government has accepted a policy of deple-

(Testimony of Jonathan B. Lovelace.)

tion charge of $27\frac{1}{2}$ per cent. We have applied that per cent in restating these earnings. So that I would like to say, because I refer to the average earnings and so forth, that restating the earnings, the figures we arrived at are as follows:

For 1932, \$35.7 per share;

1933, \$30.84.

The Court: Are you going through several years there? [278]

The Witness: I was going to give the 10-year period.

The Court: I wonder if that couldn't be put in a schedule and put in as a schedule.

Mr. Mackay: I think so.

The Court: Put it into the record here.

Mr. Mackay: It is quite all right with us.

Mr. Melville: It is my understanding, your Honor, the earnings are all stipulated.

The Court: He is showing how he has adjusted them, and he has explained how he adjusted them. I thought it might be easier if we had a schedule showing the 10 or 11 years' adjustments. We are about to suspend, anyway.

Mr. Mackay: Yes, your Honor. I can't finish this witness, anyway. I think it would be all right.

The Court: Well, possibly you may wish to have him bring such a schedule in so you can put it in as an exhibit. I am not telling you what to do. We will suspend at this time until 9:30.

(Whereupon, at 5:00 p.m., a recess was taken until 9:30 a.m., Wednesday, October 10, 1945.)

PROCEEDINGS

October 10, 1945—9:30 a.m.

The Court: You may proceed, gentlemen.

Mr. Mackay: Will you read the last question and answer?

(The record was read.)

JONATHAN B. LOVELACE
resumed his testimony as follows:

Direct Examination—Resumed

By Mr. Mackay:

Q. Have you that schedule?

A. Yes. I would like to make one correction.

Q. All right.

A. The figure referred to as the depletion charge in 1940 was not——

The Court: Well, you have a schedule now that was made out that is correct and complete straight through, do you?

The Witness: Yes, but it does not show that figure and I would like to make that correction.

The Court: Very well.

The Witness: In 1940 the correct depletion charge—the depletion actually charged was—as shown by the stipulation the figure was \$2,071.18, and this requires a correction in my earlier figures there.

(Testimony of Jonathan B. Lovelace.)

The net results are the same but the figure referred to previously as to the income after depletion [284] should have been \$499,838.80, and the depletion of \$2,071.18 made a total adjusted income of \$501,909.98, and after adjusting for depletion at 27½ per cent, the figure becomes \$318,807.75. The result of these adjustments was to decrease the indicated earnings for 1940 from \$47.61 to \$30.37, and that for the year 1942 to increase the earnings from \$11.41 to \$35.07. Because of the difference in depletion charges it increased the earnings at the end of the period and decreased them at the early part of the period because the company had made very high depletion charges in early years. For instance, in the year 1932 when the royalty income amounted to \$601,000.00, the depletion charge was \$413,000.00 according to the books, yet in 1940 when the oil royalty income was \$666,000.00, the depletion charge was only \$2,000.00. I made the adjustments to put them on an equal basis over the period and in order to make the comparison fair with listed stocks that I used as a measuring stick to check my valuations of the company.

By Mr. Mackay:

Q. Do you have a copy of the list you checked with?

A. (Producing) It was not re-typed.

The Court: Off the record.

(Discussion off the record.)

Mr. Mackay: If your Honor please, I should like to offer this in evidence. [285]

(Testimony of Jonathan B. Lovelace.)

The Court: This is the schedule that we talked about last night on the average earnings for the ten-year period?

The Witness: Yes. That is earnings by years for the period.

The Court: Very well. That may be marked Petitioner's Exhibit No. 25 and received in evidence.

(The schedule referred to was marked and received in evidence as Petitioner's Exhibit No. 25.)

By Mr. Mackay:

Q. I think you also referred to 50 stocks that you took. Have you got a copy of that?

A. Yes, sir, (producing.)

Mr. Mackay: If your Honor please, I think it would help clear the situation up if we put in a copy of the 50 stocks that he has referred to.

By Mr. Mackay:

Q. Have you got an extra copy of those?

A. The reporter yesterday took a copy.

The Court: Very well. The list of stocks may be handed to the clerk, marked Petitioner's Exhibit 26, and received in evidence.

(The stock list referred to was marked and received in evidence as Petitioner's Exhibit No. 26.) [286]

By Mr. Mackay:

Q. Did you make any further checks on your estimated value of the stock of the Dominguez Estate Company?

(Testimony of Jonathan B. Lovelace.)

A. Yes, I think I was just indicating that I was using the earning power basis as a check against the valuation of \$418.00, which has been established on an asset basis, discounting the net asset value at market to be in line with other securities available in the market at June 5, 1941, and I was adjusting the earnings to get an earnings period that could be compared with the 40 or 50 stocks that I listed. I am not sure it was put in the record, and if it is not, I would like to say now that if we value the 1940 earnings as the average of the stocks listed in the table, the value becomes \$216.00. If you value it at 8.2 times the average earnings for the five-year period, it becomes approximately \$438.00, and I considered that range—the lower range would indicate the excess valuation and I considered the range from \$215.00 to \$437.00 as being the summation of the valuation of \$418.00 by indicating it slightly on the high side.

The next step is always what the future earnings may be and compared with cash earnings, because an investor who buys securities is really only interested in what he is going to get in the future, and the past is simply an index or indication on which he can base that estimate.

In the case of the Dominguez Estate Company, by reason [287] of the stipulation of the future income to be received from the oil royalties, it is possible to make a forecast of the trend of earnings in the next ten years as compared with the past ten years. The stipulated exhibits show that in the

(Testimony of Jonathan B. Lovelace.)

ten years ending in 1941 Dominguez Estate Company received oil royalties of \$8,655,000.00 and the exhibit—I think it is 12-K—our future income from oil royalties shows that in the next ten years the company will receive \$6,062,000.00, so there is a difference of \$2,590,000.00, the company is going to receive \$2,590,000.00 less in oil royalties on the basis of the stipulated rate of income in the next ten years than they received in the past ten years. But, if you take that figure and adjust it for the oil royalty income—I mean, the depletion charge of $27\frac{1}{2}$ per cent—you get a net decline in net earnings of \$1,880,000.00 over the next ten years. In other words, the actual decline in oil royalty income of \$2,593,000.00 would only result in a reduction in earnings of \$1,880,000.00. That is an average of \$188,000.00 a year, and that amounts to \$17.91 per share of Dominguez stock, so that on the basis of the stipulated figures, if the other operations of the company were precisely the same as they had been over the last ten years, then the earnings of the company in the ten years after 1941 would be \$17.91 a share less than the reported earnings. If you take the ten year earnings as \$45.00, your estimated earnings for the next ten years would be [288] \$27.05. So, the figure of \$418.00 is rather liberal capitalization for anticipated future earnings of \$27.00 a year. In fact, that is 15 times earnings.

The figures can be shown graphically. I made a chart—

Q. Can you explain the chart?

(Testimony of Jonathan B. Lovelace.)

A. Yes. This chart——

Q. Stand up and show it so the Court can follow it, and counsel, too.

A. (Complying) This begins with the year 1932 and runs to the year 1941, and the line here of Adjusted Income shows the net income adjusted for depletion in 1932 was about \$36.00. It went up to \$68.00, and down to \$30.00 in 1941. The dividends which were less than the earnings back in the early years are now greatly exceeding earnings, shown by the spread in the red line here. The gross oil royalty income per share—all these figures are on a per share basis; I took the actual oil royalty and divided it by the number of Dominguez shares outstanding. In 1932, for example, it was about \$58.00—\$57.10. The oil royalty income per share of common stock before the final balance even with the adjustment I made was only about \$36.00 a share. Taking this oil royalty income as \$60.00 per share in 1932, it ran up to \$121.00 a share in 1938, and it has since declined from \$121.00 in 1938 down to \$70.00 per share in 1940. At the time of this appraisal the [289] rate was running at about \$70.00 a share in oil royalties, and the stipulations are—oil royalty income would advance from 1942 into the year 1943 up to \$90.00 a share, and thereafter there would set in a steady decline of \$90.00, \$60.00 and on down to \$30.00 a share by 1951. That is a declining picture in the stipulation as to the income from oil royalties.

Mr. Mackay: If your Honor please, we would

(Testimony of Jonathan B. Lovelace.)

like to offer this in evidence. It is merely explanatory.

Mr. Melville: No objection. May I have a copy of it?

Mr. Mackay: We will make a copy.

The Witness: Could I have it done better?

Mr. Mackay: We can withdraw it.

The Witness: It is rather crude. It is just my own study and I would like to have it made better.

Mr. Mackay: Would you object to that, Mr. Melville?

Mr. Melville: No, not at all.

The Witness: I will bring the other back for a check to see it is the same.

The Court: Well, we can assign an exhibit number to this particular chart and we will refer to it as Petitioner's Exhibit No. 27. The chart now in the courtroom need not be marked but when you bring the other chart in, it may be handed to the clerk and marked Exhibit No. 27 and received in evidence. We are receiving it subject to its being produced and handed to [290] the clerk. We will not take any further formal action on it unless it becomes necessary to do so.

(The chart referred to was marked and received in evidence as Petitioner's Exhibit No. 27.)

Mr. Mackay: If your Honor please, the witness referred to a number of companies here, the Consolidated Investment Trust, the Lehman Corpora-

(Testimony of Jonathan B. Lovelace.)

tion, the National Bond and Share Company, and the Los Angeles and Shawmut Association, and all the figures have been read into the record. If it would assist the court in any way we would be very happy to submit this as merely explanatory of it.

Mr. Melville: Yes, I think that is agreeable.

The Court: Very well, it may be handed to the clerk and marked Petitioner's Exhibit No. 28, and be received.

(The document referred to was marked and received in evidence as Petitioner's Exhibit No. 28.)

By Mr. Mackay:

Q. Now, Mr. Lovelace, is that all you have to say with respect to the stock of the Dominguez Estate Company?

A. I would just like to add in conclusion that the result of the forecast which is based on the stipulated figures of the declining earnings for the next ten years compared with the past ten years—there was nothing in that study to indicate that the value of \$418.00 should be adjusted upwards. If anything, there was an indication it should be lower as indicating [292] a rather liberal capitalization. Nevertheless, I did not influence my figure but stood on the figure of \$418.00 a share.

Q. As the fair market value on June 5, 1941?

A. Yes.

Q. Now, did you also make an analysis and appraisal of the stock of the Francis Land Company as of that same date?

(Testimony of Jonathan B. Lovelace.)

A. I did, and I found that the net asset value of Francis Land Company was \$459.29 per share. I arrived at that figure by taking the assets, the fair market value of the 549 shares of Dominguez Estate stock at \$418.00 a share——

Q. You mean, 5,499?

A. Yes, 5,499 shares. At \$418.00 per share that amounted to \$2,298,582.00. The liabilities of the company exceeded the other assets by \$2,109.00. Subtracting that excess of liabilities over assets from the fair market value of the Dominguez Estate, we arrived at a figure of \$2,296,473.00, and dividing that by the 5,000 shares of stock outstanding, we arrived at a net asset value of \$459.29. On that story of statement of assets and liabilities, I placed the fair market value of the Francis Land Company's stock at \$367.00 per share. That is a discount of 20 per cent from the actual net asset value based on the balance sheet in adjusting the Dominguez stock to the estimated fair market value that I placed on the holdings. It is well recognized that any company that is removed from the [292] assets, particularly a corporation, the shares of that corporation are subject to some discount as against the underlying assets. In the figures that I presented yesterday, the table that has been entered as an exhibit, it shows that the most liquid companies, the Lehman Corporation and the National Bond and Share, on the New York Stock Exchange were selling at an average discount of 30 per cent, but in this case I felt that a discount

(Testimony of Jonathan B. Lovelace.)

of 20 per cent was proper rather than applying even the minimum discount prevailing on the listed securities because of the nature of the holdings and because of the fact that Francis owned over 52 per cent of Dominguez. I felt that with that holding it would probably—that the fair market value would be subject to a less discount than would be the case on even the most liquid security. Such a holding is subject to a discount, first, because of the income flows through it is subject to a second tax. 15 per cent of the dividends are taxable at whatever rate is prevailing. The rate of 30 per cent applied to the 15 per cent of the dividends mean you lose in the taxes alone $4\frac{1}{2}$ per cent of the income from the top company. In addition, you have some minor expenses of operation, and investors obviously would only be interested in this stock at a discount from the asset value because if they were going to get it without a discount, they would rather buy the top company. I placed a discount of 20 per cent, which I think is the minimum that would be applied between the willing buyer and the willing [293] seller to the net asset value as computed.

Q. Did you also make a valuation of the stock of the Carson Estate Company?

A. I did.

Q. As of that same date?

A. I did. I took the figures as stipulated, the balance as of May 31, 1941, and added in the value of the oil properties at their stipulated values, as

(Testimony of Jonathan B. Lovelace.)

stipulated in court yesterday, which was \$285,000.00, and then I added the fair market value as I had appraised it on the stock of the Dominguez Estate Company and the fair market value of the stock of the Francis Land Company, and got balance sheet figures as follows: Current assets at stipulated values, \$201,936.00; ranch real estate at stipulated values, \$446,418.00; other real estate, at stipulated values, \$147,200.00; oil properties, at stipulated value, \$285,000.00; investments, at fair market values at June 5, 1941; 1,353 shares Dominguez Estate Company stock at \$418.00 per share, total \$565,554.00; 1,785 shares of Francis Land Company stock at \$367.00 a share, \$655,095.00; total assets, \$2,301,203.00; current liabilities, \$34,158.00; net assets, \$2,267,045.00; equivalent per share on 7,427 shares of common stock, \$305.89.

On the basis of that net asset value of \$305.89, I established a fair market value of \$214.00 per share as a fair market value of Carson stock. [294]

Then I check those figures with the earnings of Carson, taking the stipulated figures with respect to their income and their expenses and adjusting the figures for actual earnings of Dominguez and the actual earnings of Francis Land Company, and I found the earnings for the ten years of the Carson Estate Company average \$161,212.00. That is at the rate of \$24.75 per share. Those figures include an average of \$3.00 per share in profits from the sale of capital assets, but taking the total earnings of \$24.75, the price of \$214.00 is about nine

(Testimony of Jonathan B. Lovelace.)

times the average earnings of the past ten years.

If you take the future picture, it is quite unfavorable as compared with the past ten years both because of the reduction in Dominguez earnings and, secondly, the reduction in Francis earnings as shown by the projected decline in oil income over the next ten years compared with the past ten years. Then there is a further adjustment necessary because the Carson oil properties themselves are stipulated to produce less income in the next ten years than they produced in the last ten years.

Making those adjustments and assuming that the other income of Carson was the same in the next ten years as in the past, it looks as if the future earnings would be about \$13.00 to \$14.00 a share, and the valuation of \$214.00 is a liberal capitalization of that.

So, after checking on the basis of past earnings and [295] on the basis of anticipated future earnings, the figure of \$214.00 which I arrived at on an asset value basis appeared to me to be a sound value.

Q. And, so, is that your opinion as to the fair market value? A. It is.

Mr. Mackay: You may take the witness.

Cross Examination

By Mr. Melville:

Q. Mr. Lovelace, as I understand it, your principal experience has been with investment trusts since 1931? A. Yes.

Q. Have you had any experience in the oil industry? A. Not as an operating man.

(Testimony of Jonathan B. Lovelace.)

Q. What experience have you had in the oil industry? A. In analyzing oil securities.

Q. When you speak of oil securities, what kind of oil securities do you mean? Standard Oil? Texas Company? Those that are traded on the New York Stock Exchange?

A. Local securities, Kern County Land, Honolulu Oil, and securities of companies of a size large enough to command a widespread market for their shares.

Q. Those are the only oil companies that you have had any experience with, valuing the stock of those that are bought and sold on the market? [296]

A. All of which have a market because I have only been interested in securities——

Q. With a market?

A. With a market or market potentialities.

Q. Have you ever dealt in oil royalties?

A. No. I don't know what is the proper answer here, but I did not attempt to appraise the value of the oil royalties. I am appraising the stock of those companies.

Q. I appreciate that. What experience have you had with the stocks of oil royalty companies?

A. I have had a very limited experience in that. There again——

Q. That answers the question.

Mr. Mackay: Let him explain it if he wants to.

The Witness: This company is not an oil royalty company. This company's assets are more outside the oil business than in the oil business. They have

(Testimony of Jonathan B. Lovelace.)

got real estate and stocks and bonds. If I were valuing the controlled stock, I would have quite a different idea from the one I placed. If I were valuing the stock as controlled, it might have a different value.

By Mr. Melville:

Q. You are applying a discount factor because it is minority stock that you are valuing here?

A. Yes, but I would apply a discount even on controlled [297] stock, but I would not apply the discounts I did if the person has the ability to sell these assets at the prices stipulated on them, obviously.

Q. Can you tell the court how much of a discount you have applied because it is minority stock?

A. Well, I applied the measuring stick of what other minority stocks were selling at in relation to their assets.

Q. Putting it in terms of per cent, can you tell me?

A. I did not try to value it as majority stock. I applied the discount of 45 per cent from the assets because I was valuing a minority block.

Q. That was 45 per cent? A. Yes.

Q. Do you know what discount factor you would apply if you were valuing a majority stock?

A. I could not say without a study.

Q. You are familiar with the blockage rule?

A. I am not sure I know all the legal——

Q. Have you testified before in court cases involving the valuation of stocks?

(Testimony of Jonathan B. Lovelace.)

A. Yes, I have.

Q. Have you ever had a real large block to value?

A. Yes, I have had a substantial block to value.

Q. Have you ever discounted it by reason of the fact that it was such a large block, on the theory that if it were [298] dumped on the market all at about the same time it would depress the market?

A. That applies to stocks that already have an established market. You cannot apply that to a company that has no market at all.

Q. I appreciate that. Have you ever had occasion to value the stocks of a company that is listed on the market wherein you were valuing a large block?

A. Not in a court case.

Q. If you were valuing such a block, would you take a discount by reason of the fact that it was a large block?

A. Well, not necessarily from the figures that I have used. The discount you would apply has to be decided in each case. In some cases, if the block were large enough to command competition between investment bankers, you might get actually a less discount if you had a small block which did not offer enough gross profit to interest competition among underwriting firms.

Q. In both cases, as I understand it, though, regardless of its size, if it was a block you would apply a discount factor?

A. Yes, you would have to allow a discount for selling. For instance, on the New York Stock Ex-

(Testimony of Jonathan B. Lovelace.)

change even when the blocks run over \$75,000.00 worth, the commission is not the ordinary stock exchange commission but runs anywhere from two [299] to six per cent, what they call special offerings. It is a new development that has come up because of the limited markets prevailing even on the New York Stock Exchange.

Q. Let us take, for example, now, a small corporation with, let us say, 50,000 shares outstanding of common stock. As I understand your testimony, if you were valuing a substantial portion of that, like 40,000 shares, you would apply a discount because it was a large block, and if you were valuing a small number of shares like 100 or 200, you would apply a discount because it is a minority interest? Is that your testimony?

A. Not in those ratios. You say "a large block" and you mentioned, I think, 40,000 out of 50,000?

Q. That is right.

A. That would be control and that would be quit different. I would consider, if you were selling a block of, say, 10,000 shares out of 50,000 shares, the discount per share might not be as great as if you were only selling 200 shares of the stock.

Q. But it would be a discount?

A. Yes, because there is the cost of marketing securities.

Q. What I am trying to get from you, if I can, is—now, we have got this corporation with 50,000 shares; how many shares of 50,000 would pass between the willing buyer and willing seller without

(Testimony of Jonathan B. Lovelace.)

a discount either by reason of blockage on one [300] side or minority interest on the other?

A. A discount from what, now?

Q. From what you would otherwise say was the fair market price?

A. I have taken no discounts from fair market price. I took a discount from the value of the underlying assets. In other words, the stock of the company is not worth as much as the assets of that company are to the corporation itself.

Q. Didn't you say you applied a discount in this case because it was such a small number of shares, it was not control?

A. But I was not discounting from market value.

Q. What were you discounting from?

A. The net asset value, that is, taking the balance sheet of the company as stipulated and putting in the value of the oil royalties, I came out with a net asset figure, and I said anyone being asked to purchase that stock would only buy it as a discount of 45 per cent from that value.

Q. Fine. So, in valuing a small number of shares, you do take a discount from asset value to arrive at your fair market value? A. Yes.

Q. And in valuing a block of 10,000 out of 50,000, you take a different discount?

A. It would not be radically different from that.

Q. You say it would not be?

A. No, not from that. It might be 40 or 42. I would have to study it.

Q. But it still would be a discount from the asset

(Testimony of Jonathan B. Lovelace.)

value to arrive at the market value?

A. Yes, because the fair market value indicates a willing buyer and willing seller and I do not think anyone would buy into a corporation with a limited market except at a substantial discount from the net asset value. I used the illustration there of the Security Company. There is a company well known in Los Angeles. The president of it is the president of the Security-First National Bank with about \$5,000,000.00 of assets. I have the statement here.

Q. I think you have answered the question. I don't want to cut short your explanation, but I don't want you to take me afield from the line of cross examination that I am pursuing.

A. I would say that your discount would depend upon conditions at the time and the availability of other securities and discounts from their asset values.

Q. You understand I did not ask you the amount of the discount, only the fact that you take a discount? A. Yes.

Q. Let us go up; we have come from 200 shares to 10,000 shares out of 50,000. If you were valuing 20,000 shares, would you take a discount from asset value to arrive at the fair market [302] value?

A. Yes.

Q. Is there any point now, going up the scale, at which you would not take a discount from your asset value either by reason of the fact you have a

(Testimony of Jonathan B. Lovelace.)

small number of shares or by reason of the fact that you have a large block?

A. If you had control and were in position to liquidate the company, if the size of the block was such that it constituted effective control in itself, I would apply a discount based on the cost of marketing the underlying assets and the length of time it would require to convert that into cash, and those discounts run anywhere from 10 to 25 per cent.

Q. So that in all cases, both below and above 50 per cent of the total stock outstanding, you would take some discount?

A. Yes, because there is some cost of marketing those assets. Those assets at stipulated values are the fair market values but not the net amount that can be realized.

Q. What were the names of the oil royalty companies in which you have dealt in their stock?

A. It has been some years and I told you they are not important. It is the Marland Company, I think the name is changed now, and I have not dealt with them for five or six years. I have not been interested.

Q. Have you had any experience in the real estate business? [303]

A. No, not as agent.

Q. Have you ever dealt with stocks of real estate companies?

A. Yes. I checked into one company here just as a comparison on this discount that I had applied. There is a company here called the Central Busi-

(Testimony of Jonathan B. Lovelace.)

ness Properties and that stock has a book value—the Central Business Properties own properties on Hope Street here in Los Angeles and it has a book value, according to the company's books, of \$57.32 a share. It has a net asset value with real estate adjusted to market of \$20.84. In other words, the market value was considerably below the book value, but that figure of \$20.84 would correspond with the stipulated figures that I used here. That stock was selling on June 5th at \$5.50. That is a discount of 73.6 per cent from the fair value.

There is a second company here called the Pioneer Securities Corporation, a company that had net cash assets on May 31, 1941, of \$114,000.00; it had marketable securities of \$63,000.00; real estate on Wilshire Boulevard practically from Grand Street up to Figueroa, which they carried at \$918,000.00, and the fair value of which was placed at \$662,000.00. So, taking the fair value instead of the book value of the real estate, the shares of that company had an asset value of \$47.19, and it was selling on the market on June 8th—no sales on the 5th—at \$14.00 a share, with an asset value, as I say, [304] of \$47.19. So, that stock was selling at a discount of 70 per cent. So, when you get into real estate companies, you find the discount much larger than anything that applies to more marketable situations.

Q. Did you consider those two real estate companies when you were valuing the stock in this case? A. No.

(Testimony of Jonathan B. Lovelace.)

Q. And you gave no consideration to it whatsoever?

A. Not until after I arrived at my value. I used them as a check. I went around to check other companies to see at what discounts the real estate companies were selling.

Q. Did you check any other real estate companies besides these two?

A. No. They were the only ones where I could get an estimate of the fair value of real estate. To get on a comparable basis you would have to have an appraisal made of the properties of the companies. You would not just accept the book values any more than you have accepted the book values of Dominguez.

Q. What values did you use, then, in these two companies? A. Sir?

Q. What values did you use, then, in making the comparison with these two real estate companies? A. I used an appraised value.

Q. Who appraised it? [305]

A. I bought into both of those companies and I had, I think, a fellow named Rolap, I would have to check my records for the name—you asked me if I dealt in them and I was just telling you how we had——

Q. You bought some yourself?

A. Yes. We later bought this Pioneer Securities Company and liquidated the company, and when we bought it and knew it was to be liquidated, we bought at a 20 per cent discount from the values

(Testimony of Jonathan B. Lovelace.)

at that time. That was in the first part of this year.

Q. Did you make a profit on the liquidation?

A. Yes.

Q. Then you have not considered any real estate companies that were operating at a loss, have you?

A. No.

Q. Isn't the real estate that is involved in the Dominguez Estate Company being carried at a loss?

A. Yes, it appears to be.

Q. What do you mean, it appears to be?

A. I don't know what general administrative expense is allocated between the oil—I don't know what costs apply to that.

Q. Haven't you been furnished with a complete copy of the stipulation? A. Yes. [306]

Q. Isn't there an allocation there for you?

A. Yes. I didn't figure it out.

Q. What do you mean, you did not know?

A. I didn't figure it out. It was immaterial to me because if I was evaluating the control of the stock, then I would try to get at the individual situation to see if the real estate could be sold, what it would be sold for, and what the oil royalties would be worth. But here we are evaluating the stock of the company in which the potential buyer must consider it is going to be run just as it has been run in the past.

Q. And you have so considered it?

A. Yes.

Q. Do you have the real estate charted on what has been referred to as Exhibit 27?

(Testimony of Jonathan B. Lovelace.)

A. No, I haven't, no.

Q. Has it been your assumption, then, that the Dominguez Estate Company will continue carrying the real estate and paying taxes and other expenses which might be involved and as a result continue carrying it at a loss? A. I——

Q. Have you assumed that or not?

A. No. I assumed there would be some improvement, but not materially, not enough to offset the decline of earnings on the oil. [307]

Q. What improvement did you assume?

A. I assumed that the future earnings would be about, I think, \$8.00 a share per annum in the next ten years better than they would have been, adjusting for the decline in oil income, but I felt that would be more than offset by higher taxes. In 1941, you will recall we were faced with substantially higher taxes, and all the evidence of that time, the demands of the Treasury and the President, were towards higher taxes, and I felt that the higher taxes which we were faced with from 1941 on would more than offset any improvement in the real estate situation.

Q. Is it not a fact that the principal reason why real estate is being carried by this company at a loss is because of taxes?

A. I don't know that to be a fact, no.

Q. Would taxes be reflected in the carrying charges with respect to the real estate?

A. You mean the cost of—you mean the property taxes?

(Testimony of Jonathan B. Lovelace.)

Q. Yes.

A. I was not talking of those. I was talking about federal income taxes and the state franchise taxes which are based on the net income of the corporation. The property taxes are part of the operating expense. I don't know of any reason to assume that property taxes would be lowered, but I was not speaking of increases there. I was speaking of increases [308] in the corporate income tax rates.

Q. Now, Mr. Lovelace, it is a fact that this real estate was being carried at a loss? A. Yes.

Q. And since you would assume that it was not likely that the property taxes would be decreased, and since it is reasonable to assume that income taxes would be increased, why did you assume that the corporation would not continue carrying this real estate at least the loss that they had been carrying it at prior to 1941?

A. I assumed that there would be some improvement in income. I had no reason to assume that they would not continue to carry the properties, but I thought there should be some improvement in the operating situation.

Q. Isn't it fair to assume that the very fact that a corporation carries real estate from year to year and pays taxes on it—that it is doing so for what they consider to be inevitable appreciation in the value of that real estate?

A. In the opinion of that particular management, yes, but there are differences of opinion.

(Testimony of Jonathan B. Lovelace.)

Q. If they had thought otherwise, they would dispose of it, wouldn't they?

A. There might be other reasons of tax consideration that I would not know about, but I would think that if they thought it was going to go down, they would dispose of it. [309]

Q. Doesn't it inferentially follow that the fact that they hang on to it indicates they thought it was going to go up?

A. Yes, I presume so, but in that connection the stipulated values have been put in as to the value of the real estate, and that is a good deal less than the cost. There is a tendency of a lot of people, when they pay a high price for something, to hold onto it until they get that price back without considering the relative values.

Q. Don't you understand that the stipulated fair market value of that real estate is the value at which it could have been turned into cash on June 5, 1941?

A. Yes, but it was not.

Q. That is right, and the fact that it was not indicates to you just what?

A. Well, that the management believed in that real estate and thought eventually it would be worth that much or more.

Q. Correct. Now, besides real estate what are the other—withdraw that, please.

Are you familiar with the profits the Dominguez Estate Company made from subdivision operations in the years prior to 1941?

A. I made no study of it because I took the pic-

(Testimony of Jonathan B. Lovelace.)

ture of the company as a whole, the picture of the earning power that [310] came out of that situation as it exists.

Q. You didn't even know, then, that they did make profits from subdivision of their real estate?

A. Yes, I saw some profits; I did not know what they came from.

Q. You did not consider it?

A. I did not consider it because you had already said what the fair value of that was.

Q. Besides real estate, now, what other activities does the Dominguez Estate Company carry on?

A. Well, the assets consist of current assets, the ownership of stocks and bonds, the two classes of real estate, and the ownership of oil royalties.

Q. And how would you compare them, now, with each other with respect to their relative importance?

A. Well, as at June 5th, taking the stipulated values of the current assets, stocks and bonds, real estate, and the value of \$3,000,000.00 for the oil royalties, the total would be \$7,979,000.00, so that the oil situation would be about $\frac{3}{8}$ per cent, a little less than 40 per cent of the total.

Q. How about real estate?

A. Well, I am just figuring this in my head, now.

Q. I don't want you to figure out the percentages. Which would be the most important to the Dominguez Estate Company, their oil royalty interests, their real estate, or their investment [311] in marketable securities?

(Testimony of Jonathan B. Lovelace.)

A. Well, on an asset value basis their real estate would be more important, on the basis of stipulated values. On the basis of earning power, the oil is more important to them.

Q. Now, didn't you find it a little difficult to value the stock of a company whose most important activity is real estate where the real estate is being carried at a loss?

A. No, I was taking the earnings of the company as a total, the final net income shown from operations, because I felt that this block was not a block that could either change the management or order the sale of any particular items that it had.

Q. And you applied the same discount factors, then, capitalization factors to each and all of the assets?

A. I did not apply any discount to the assets. I applied the discount to the net assets of the company as a whole.

Q. That is what I mean.

A. Just as if someone—I would like to use the comparison again of the Security Company. The assets of that company consist of real estate of \$1,100,000.00, marketable securities of \$3,000,000.00, and that worked out to a total book value there, total net asset value with everything valued at the market, and then I compared the market price of that to that value and saw that the discount was 39 per cent—38 per cent—so, I said, “Here is a company with assets of \$67.60 [312] a share, its assets not as liquid as those of the Security Com-

(Testimony of Jonathan B. Lovelace.)

pany," and I said that the discount obviously should be higher than that of a readily marketable security in a very productive situation in which almost all of the assets were earning money at that time, and I applied the discount of 45 per cent.

Q. To the assets as a whole? A. Yes.

Q. Disregarding the fact that if those assets there were stocks and bonds which are marketable, high grade stocks and bonds, on which the interest rate would be—how much would you say?

A. Well, probably 4 per cent on an average. In 1941 it would be higher than that, probably 5 or 6 per cent.

Q. Do you think this corporation is getting 5 or 6 per cent on the grade of bonds and stocks that they are carrying?

A. In 1941 values, they should be getting close to that. The list that I recited shows that in 1941 those stocks were yielding over 9 per cent, 9½ per cent. They were all very high grade stocks, General Motors, Chrysler, Chesapeake & Ohio, Union Pacific, Pennsylvania Railroad. If you figure the yield on the market at June 5th, I would think that if they were not getting over five per cent it was not being aggressively managed.

Q. I believe you testified, then, that of the three departments, real estate was of the most important, oil royalties [313] second, and of least importance were the investments in marketable securities?

A. I said on the asset value basis. I said that

(Testimony of Jonathan B. Lovelace.)

on the earnings basis the oils were much more important.

Q. Now, Mr. Lovelace, if you were to value a personal holding company that had \$1,000,000.00 capitalization, and all of the stock was in the hands of a small group of individuals, a family corporation, let us say; they had just formed the corporation and they had not gotten around to making any investments yet, the \$1,000,000.00 was in the bank in a savings account drawing one-half of one per cent interest, how would you value that corporation?

A. You mean at June 5th?

Q. No.

A. Well, the value would depend on the time because it depends on the attitude of the investor.

Q. I am after your methods. I don't want to relate this back to June 5th, necessarily. You can take June 5th or today, whichever you like.

A. I would have to relate it back because the discount that people require to go into a frozen situation varies with their sentiments.

Q. Then let us go back to June 5, 1941.

A. On June 5, 1941, investors were not in a frame of mind—if the money was in the bank they would be afraid of any [314] attempt to put it into some unwise venture, and I think they would require a substantial discount. I think they might require more, because in 1941 a tremendous premium was paid on liquidity.

Q. These assets were liquid.

A. Yes, but the others you asked me to value

(Testimony of Jonathan B. Lovelace.)

are not liquid. I am not quarreling with the value of the money in the bank or the values that have been arrived at here, but I say if a man has a share in there—it is just as if three of us own a piece of property, if one of us does not have the right to sell it, it is not worth as much to us as if we controlled the property because we have to stand by the results of somebody else's decision.

Q. Let us say within the family. Supposing you and your wife and your father and your mother and your children owned the stock of this corporation and they have got \$1,000,000.00 in the bank drawing one-half of one per cent of interest on June 5, 1941, what is that stock worth?

A. To whom? To a willing buyer?

Q. To the people that own it?

A. To a willing buyer—if the people that own it, enough of them, have a right to liquidate it and take their money out, then it is worth asset value, but if the man is in a minority position, it is worth what he thinks will be the ultimate results of that employment of those funds. [315]

Q. How would you go about valuing the stock of such a corporation?

A. Well, it would be rather difficult without knowing what the corporation was going to do, and this is a rather unusual situation.

Q. It is your stock, you and your wife and your father and your mother and your children own it; you are not going to sell it unless you can get what you think it is worth. If a willing buyer comes

(Testimony of Jonathan B. Lovelace.)

along and offers you a price and you don't think that is enough, you will not sell it, and therefore there will not be a sale, isn't that right?

A. Yes.

Q. The only time a sale will occur is when the willing buyer comes up to the price that the willing seller is willing to take for it? Right?

A. Yes.

Q. All right, now, it is your stock; how would you value it and what would you sell it for?

A. You want to get what the willing buyer would pay for it?

Q. No.

A. If it was June 5th and I had that situation, I would sell at a substantial discount because I could see I could use the money in other situations. When you buy Lehman Corporation, you are buying cash in the bank, securities that can be sold [318] overnight, you are actually buying the same thing you are talking about and you could buy it at a 29 per cent discount.

Q. How much would you take for the stock you were owning in this company?

Mr. Mackay: Will you clarify that, how much stock is he owning?

Mr. Melville: He can assume any figure he wants to.

The Witness: If I had control I would not take any discount. If I were a minority stockholder and did not know what the policies of the company were going to be——

(Testimony of Jonathan B. Lovelace.)

My Mr. Melville:

Q. Let us assume all the facts that I have previously stated now with respect to this family group, and let us assume that you owned out of 10,000 shares representing this \$1,000,000.00 worth of assets—let us assume that you own 200 shares.

A. Well, I would take a discount of around 25 to 30 per cent.

Q. You would be willing to sell for that?

A. I would.

Q. Let us assume that your father owned 5,000 of the 10,000 shares; what would that stock be worth to him?

A. Well, what state is it incorporated in? If it was in Delaware, it would not be worth much.

Q. California. [317]

A. A California corporation? I think 50 per cent would liquidate.

Q. Well, let us make it 55.

A. Then I would say it would be worth face value to him less whatever the cost of clearing the money out through the bank.

Q. That is, it would be worth——

A. About 99 per cent, probably.

Q. 99 per cent of the asset value back on the stock? Right? A. Yes.

Q. If it is worth that much to him, why wouldn't he pay you that much for your 200 shares?

A. Well, he has all he wants. He has the control.

Q. If it is worth that much to him, he would be

(Testimony of Jonathan B. Lovelace.)

getting a bargain to get 200 shares more at the price you would be willing to sell for?

A. Possibly he would. It is a hypothetical case.

Q. Yes, but that is what we are dealing with.

A. I think he might say—he would probably say, “Son, I hate to see you take this loss, but if you want to sell it at a 30 per cent discount, I will buy it from you.”

Q. Knowing full well it was worth 100 per cent or 99 per cent? A. To him. [318]

Q. Is it not a fact that the market in stocks is made by willing sellers who are desirous of getting the highest price possible and by willing buyers who are desirous of making as good a buy as possible? A. Yes.

Q. All right. Now, you have stated what you thought the stock was worth in your hands, you would take a 25 per cent discount; you have stated what you thought you father would figure it was worth in his hands, 99 per cent of the asset value; now, you are going to sell that stock to your father, you know what it is worth to him, would you sell it for a 25 per cent discount?

A. Yes, because I would be selling it because of what I could do with the money somewhere else.

Q. Wouldn't you sell it for the highest price you could get?

A. I might say that I thought I ought to get a little more, but you asked what I would take for it and I said I would take a discount of 25 to 30 per cent, and be glad to get it. When you speak

(Testimony of Jonathan B. Lovelace.)

of the willing buyer and the willing seller, both the willing buyer and willing seller are both greatly influenced by the conditions prevailing at the time they meet. We had a case in 1929 where the Lehman Corporation had what you said, the cash in the bank, and the stock sold at approximately 40 per cent discount because people thought they could do magic [319] with it. In 1941 there was a great apprehension on the part of investors that it was the end of the capitalistic system. There was a great fear in those times and people wanted control of their own funds and they required a very large discount to go into any non-liquid situation.

Q. Were you talking about Lehman Brothers?

A. Lehman Brothers. It is now selling at a discount of 29 per cent.

Q. What business are they in?

A. The business of buying and holding bonds and stocks.

Q. Investment trust? A. Yes.

Q. Is the Dominguez Estate Company an investment trust?

A. No, it is a personal holding company.

Q. And it is not an investment trust?

A. Not within the meaning of the Act. The only reason it is not is because the Act excludes personal holding companies. It would be called an investment trust but there happens to be a legal definition of investment trusts in the Securities Act.

(Testimony of Jonathan B. Lovelace.)

Q. In your opinion is it comparable to an investment trust?

A. Reasonably comparable, yes.

Q. Do you know any other investment trusts that derive their principal income from oil royalties?

A. Yes—not royalties. Oil securities. The Petroleum Corporation of America buys and holds nothing but oil stocks.

Q. But they are not deriving their principal income from oil royalties?

A. From oil profits.

Q. I am asking you about oil royalties.

A. Not to my knowledge.

Q. You don't know of any investment trusts that derive its principal income from oil royalties?

A. No.

Q. But this Dominguez Estate Company that we are dealing with does derive its principal income from oil royalties?

A. Yes.

Q. So they are not very comparable, are they?

A. Every investment trust differs in the type of things it invests in. As a general type, they are reasonable comparable.

Q. Do you know of any investment trusts that hold large amounts of city and ranch real estate?

A. Not offhand. I know a good many of them that did and all of them disposed of it.

Q. Is it not a fact, Mr. Lovelace, that only to the extent that the Dominguez Estate Company holds marketable securities is it similar to——

A. No, to the extent that it holds assets for

(Testimony of Jonathan B. Lovelace.)

investment [321] purposes. This is similar from the standpoint of the ownership of the real estate, securities, and oil royalties. You will find some investment trusts that will be just that way except that one may own RKO Theater, and another may own just one particular thing. The companies I used all had broad lists of securities, practically the same as cash.

Q. All of the investment trusts you had in your comparison hold nothing but marketable securities?

A. That is right.

Q. Isn't that true of most investment trusts?

A. Well, most in number but possibly not in size. I would have to check on that.

Q. But you did not make any comparison with the others?

A. Yes; the discounts on the others run higher, most of them, than these I used.

Q. You did not use any others except the investment trusts that held only marketable securities?

A. At this ratio, no.

Q. In this comparison?

A. That is right. I just testified that where I did find a company that owned city real estate, the discounts were much larger.

Q. What investment trust holds city real estate?

A. Pioneer Securities, that I referred to. Its assets were practically half in real estate, and the real estate was [322] all earning good money, making a good return.

Q. Is that an investment trust?

(Testimony of Jonathan B. Lovelace.)

A. It was an investment trust in every extent except a technicality. It was technically called a personal holding company also, but it owned marketable securities and—I gave the figures just now. It had \$114,000.00 in cash assets, \$63,000.00 in marketable securities, and \$918,000.00 in real estate on Wilshire Boulevard.

Q. You think that a comparable corporation to the Dominguez Estate Company?

A. Well, nothing is strictly comparable, no. This discount is 70 per cent and I only applied a discount of 45.

Q. Did you consider that company in arriving at your discount of 45?

A. No; I checked it afterwards. I did not take it into account at all in arriving at the discount. If I had, I would probably have used a larger discount.

Q. Is the Dominguez Estate Company what you would call a family holding company?

A. Well, I say it is a greatly mixed up holding company in this whole situation.

Q. In your opinion, it either is or is not a family holding company. Just answer the question.

A. I think it probably is. I did not study it from that angle. [323]

Q. Have you ever considered the stocks of other family holding companies to ascertain the fair market value of them?

A. Well, the nearest to this, as I said, is Pioneer Securities. That I considered to be an investment company, but technically it was rated as a family

(Testimony of Jonathan B. Lovelace.)

holding company because the control was owned by Lee A. Phillips Corporation, in much the same way that Carson owns the control of Dominguez.

Q. Is it your understanding that Carson owns Dominguez?

A. No. It is 55 per cent of the stock, as I recall—no, 52.4 per cent, 5,499 shares. Did I say Carsen? I meant Francis. I beg your pardon. I meant to say the Francis Land Company.

Q. What stocks of family holding companies can you name for which you could obtain stock prices as at June 5, 1941?

A. I don't know of any.

Q. Is the answer "none"?

A. I wouldn't say that. I would say I don't know of any because the market for shares of family holding companies is obviously very limited.

Mr. Melville: Opposing counsel has indicated he would like a short recess.

The Court: Very well.

(A short recess.)

Mr. Melville: Will the reporter read the last question and answer? [324]

(The record was read.)

By Mr. Melville:

Q. It seems to me, Mr. Lovelace, that that question does not have to be qualified in that way. I asked, what stocks of family corporations, if any, can you name for which you could obtain stock prices as at June 5, 1941?

(Testimony of Jonathan B. Lovelace.)

A. I said I did not know of any, but that does not mean there are not any.

Q. Can you name any? A. I cannot.

Q. That answers the question. It follows, then, that you did not make any comparison in valuing the stock in our case, the Dominguez Estate Company, the Francis Land Company, or Carson Estate Company, with the stocks of any other family corporations?

A. No; I said it did compare—after making a study I did compare it with the Pioneer Securities, which is a family holding company technically, controlled by the Phillips Estate.

Q. Is that a family holding company?

A. The Lee A. Phillips Corporation owned over 50 per cent of the Pioneer Securities.

Q. It seems to me that unless you are going to change your testimony, it is not a family holding company, because a few moments ago you stated that you could not name——

A. I said I considered it to be an investment company, [325] just as I considered this was essentially an investment company from the standpoint of the fair market value of the outstanding securities, but, technically, the Security and Exchange Commission says that an investment company is a company which has over 50 stockholders, and it might have all the characteristics in size and everything else of an investment company, but if it does not have over 50 stockholders, then it is not an investment company.

(Testimony of Jonathan B. Lovelace.)

Q. Where did you get your stock prices with which you made your comparison?

A. I got them from brokers, three brokers, and I was following the stocks myself at that time. I know of the transactions that took place. I did not buy the stock. It took place shortly after June 5, 1941, and, as I said, I continued to follow the company and we actually purchased control of the company here about four months ago, and we purchased it at a discount of 20 per cent from the then asset value.

Q. I am sorry, I am not too clear. It either is a family holding company or it is something else. What is it? I am not trying to tell you what it is. I want you to tell the court what it is.

A. Well, it is considered a family holding company.

Q. Then we will go back to the other question, and I think you want to change your testimony. I asked you whether you could name—what stocks of family holding companies can [326] you name for which you could obtain stock prices as at June 5, 1941? Do you want to change your answer?

A. Yes, using the technical definition of the company, I would say that Pioneer Securities, I am advised, is considered a family holding company.

Q. Who owns the stock?

A. The stock is owned, the majority control, by Lee A. Phillips Corporation, and his daughter, Mrs. Arline Morrison.

Q. Do you own some of the stock?

(Testimony of Jonathan B. Lovelace.)

A. Not now. It is all liquidated and wound up.

Q. Did you own some of the stock?

A. No; my corporation did.

Q. How much stock was outstanding in 1941?

A. 30,000 shares.

Q. How was it distributed between stockholders?

A. I haven't the stockholders' list at that time.

I think there were about 45 stockholders.

Q. Who held them?

A. I haven't the names. I can get that for you but I haven't—I told you I didn't take that into account in valuing this company.

Q. How much did your corporation own?

A. We made a bid contingent on 66-2/3 per cent accepting it because we wanted to be in position to liquidate, and 66-2/3 per cent was necessary because that was a Delaware Corporation, [327] and 80 per cent deposited, and——

Q. That is not answering my question.

A. What?

Q. How much stock did your corporation own?

A. When?

Q. June 5, 1941?

A. None on June 5, 1941.

Q. Do you know who owned it on June 5, 1941?

A. No.

Q. Then why can you say that it was in your opinion a family holding company?

A. Because of the record of the company. I said I am advised that it was. We were told by lawyers in 1945 that it was a personal holding company and

(Testimony of Jonathan B. Lovelace.)

they gave a list of the stockholders, and there has been no change in the situation since 1940.

Q. Are you using the terms "personal holding company", "family holding company", and "family corporation" as synonymous?

A. Well, I was using them in roughly the same category. If by a family holding company you mean a personal holding company which members of one family control, then it is the same thing.

Q. You would call Dominguez Estate Company a family holding company, wouldn't you?

A. It is a personal holding company in which members of [328] the family directly or indirectly have control.

Q. Didn't you base your asset valuation of Dominguez Estate Company on a comparison with five investment trust companies?

A. That was one element of valuation on the asset value basis. Then I valued it in comparison with the other stocks available on the New York Stock Exchange in relation to their 1940 earnings and their 1936 to 1940 average earnings. I found, on the basis of the 1940 earnings, if you valued Dominguez the same as these leading stocks on the New York Stock Exchange, it would have been worth only \$215.00, but I found on the basis of the average earnings it was worth \$437.00, and within that range I took nearer the higher value.

Mr. Melville: I might suggest, your Honor, that if the witness would answer the questions and then stop—I don't mind him explaining, he can explain

(Testimony of Jonathan B. Lovelace.)

all he wants, I have as much time as anybody, but when I ask a question, he might as well answer it and then stop. If he wants to make an explanation, he might ask to explain it.

The Court: Well, we are getting along reasonably well. Sometimes the witness will elaborate too much.

Mr. Melville: I am agreeable. The more he talks, the better off I am, I think.

The Court: The witness will, so nearly as possible, answer the question directly and stop. [329]

By Mr. Melville:

Q. And of those five investment trust companies which you considered, what is the percentage of market value of their stocks to the book value of their assets?

A. The market value of the stocks of these investment trusts to their——

Q. To their book value of assets.

A. What do you mean by the book value of their assets?

Q. Did you consider, in making your appraisal, five investment trusts? A. I did.

Q. Did you consider the book value of their assets, yes or no?

A. I don't know what you mean by book value.

Q. Did you consider in any way the value of their assets?

A. I took the value of their assets at market on March 31, 1941, and the market value of their assets taken item by item and adding them up, I

(Testimony of Jonathan B. Lovelace.)

arrived at a net asset value figure per share. It is on that table I gave you.

Q. What are you going to make a comparison with now? The question was, what the percentage of market value on their stocks were in comparison to the book value of their assets.

A. The value of the assets—let us take one company. The Security Company had certain assets---

Q. What was the value of the assets?

A. That is the figure per share given you there.

Q. In other words, is it your testimony that in valuing an investment trust, the value of the assets is exactly the same as the market value of their stocks?

A. That is the value of the underlying assets, yes; what we call net asset value.

Mr. Mackay: Did you want to see this exhibit?

The Witness: Yes, I would like to see it.

(The paper was handed to the witness.)

The Witness: In other words, take the Security Company, it had certain cash and you take the cash value of that.

By Mr. Melville:

Q. No discount?

A. Not in that instance.

Q. All right.

A. Then we take the appraised value of the real estate.

Q. I thought you said before that you did not know any investment trusts that owned real estate?

A. No. You asked me where the majority of

(Testimony of Jonathan B. Lovelace.)

the assets were real estate; your question was, a company in which the majority of the assets consisted of real estate.

Q. And you are now talking about some investment trusts that have real estate? [331]

A. The Security Company, yes, sir, right here in Los Angeles.

Q. Is it the real estate which they occupy for office space?

A. No, it is for investment purposes. You take the cash they had on hand, and we take the real estate at an appraised value.

Q. Who made that appraisal?

A. The management of the Security—the Board of Directors of the Security Company.

Q. The Board of Directors made the appraisal?

A. Yes.

Q. What is that appraisal supposed to represent?

A. It represents the fair value of the real estate, which was \$152,000.00 below the book carrying value. They carried it on the books at \$768,000.00, and they appraised the value at \$152,000.00 less than that.

Q. And you accepted that appraisal in making your study?

A. Yes. We used—excuse me.

Q. Then, to what extent is your opinion based upon the opinion of the Board of Directors?

A. Of the assets owned by the Security Company, the real estate amounted to less than 10 per cent of the total assets, and to the extent I took

(Testimony of Jonathan B. Lovelace.)

the value of the real estate, comprising ten per cent of the assets, I took the opinion of [332] somebody else with respect to that much of the assets. You asked me how it added up. Then we took the securities at the market value, taking only the bid price for every asset they owned, and we added those up and subtracted the liabilities and divided by the shares outstanding, and that is the way we arrived at the figure of \$48.36.

Q. You have the sheet in front of you, haven't you? A. Yes.

Q. What is the value of the assets?

A. I have not got the precise figures—I have not got my work sheets—but the assets were \$5,700,000.00.

Q. Is that the book value?

A. No, that is asset value based on the fair market value of the independent items.

Q. Do you have book value? A. No.

Q. Then you cannot answer my question as to the percentage the market value of their stocks is to the book value of their assets?

A. No. That is the reason I asked you to define book value, because book value in the case of an investment company would mean the cost of those securities to that company.

Q. Did any of the five companies with which you made comparisons have bonds or preferred stock outstanding, yes or no? [333] A. No.

Q. I believe that in your direct examination you

(Testimony of Jonathan B. Lovelace.)

selected about 50 companies for your earnings basis of valuation? A. Yes.

Q. How many of those companies were oil royalty companies? A. None.

Q. How many were real estate companies?

A. None.

Q. How many were oil producing companies?

A. Five.

Q. Were those also oil refining companies?

A. Yes.

Q. Do you consider an oil refining company and an oil producing company comparable to the Dominguez Estate Company?

A. No; I was not making that comparison.

Q. How many had outstanding preferred stocks?

A. I would have to compute it. I don't know.

Q. Do you think that most of them did?

A. My guess would be that most of them did not.

Q. I presume your answer of "I don't know" would apply to the question about their outstanding bonds, debentures, mortgages, and other indebtednesses? [334]

A. I can give you item by item.

Q. Have you got it there?

A. Yes, I have got a table that covers all of it. I can work it out.

Q. I don't want you to go into too much detail, Mr. Lovelace. I just want to get the picture before the Court. If you can give me a rough estimate of how many had outstanding funded debts, such as

(Testimony of Jonathan B. Lovelace.)

bonds, debentures, mortgages, and other indebtedness, I would accept your answer.

A. I could not give you that. I would rather go down it item by item.

Q. I doubt that it is worth the time if you don't know offhand. I will withdraw the question.

I believe yesterday you mentioned 9.6 per cent yield, is that correct? A. Yes.

Q. What did you mean by that?

A. That is the dividend rate paid in 1940, or announced for 1941, divided by the market price of June 5, 1941.

Q. Where did you get it?

A. Commercial Financial Chronicle, and checked with Moody's.

Q. And that is the composite of all of these 50 companies that you considered?

A. That is the average of the 50. [335]

Q. The average? A. Yes.

Q. Then you did not—did you or did you not consider the funded debts and preferred stocks in arriving at that figure?

A. No, this is the per share earnings on the stock that a man could purchase. There is no relationship there.

Q. From that you arrived at the 7.1 times 1941 earnings, didn't you?

A. Not from the dividends, no. I took the actual earnings reported in 1940 and adjusted them where there had been a change in the capitalization, and divided those earnings by the market price—divided

(Testimony of Jonathan B. Lovelace.)

the market price on June 5, 1941, by the earnings per share reported in 1940.

Q. And that gave you what figure?

A. About 7 times, 7.2 times, as I recall.

Q. In arriving at that 7.1 or 7.2, you did not consider the funded debts and the preferred stocks in computing that figure, did you?

A. You mean to get the overall times earnings?

Q. Yes.

A. No. The majority of these companies have only one class of stock, like Chrysler Corporation, and so on.

Q. Do I understand, then, that you made your comparison on the basis of the value of the common stock only, rather than [336] on the basis of any bonds or preferred stock which those corporations may have had outstanding?

A. That is right. That figure arrived at that way was \$216.00.

Q. Mr. Lovelace, if you were considering two houses, each worth \$10,000.00, would you consider that full ownership of one was no different than an ownership equity of \$2,000.00 in the other on which there was a \$8,000.00 mortgage?

A. Well, if the mortgage rate were low enough, the \$2,000.00 would be advantageous. I would not consider them the same.

Q. You would not consider them the same?

A. No.

Q. Then why did you not consider—withdraw that question.

(Testimony of Jonathan B. Lovelace.)

You would consider, then, the mortgage in determining your fair market value?

A. Fair market value of what?

Q. The house.

A. The mortgage is part of the value. The mortgage is a liability, it is not part of the value. If you value the house and deduct the mortgage, then the equity might be worth a lot more. If the mortgage was low enough and ran long enough, it might be worth a lot more than if it had no mortgage.

Q. Let us assume two houses, and this chair is one and [337] that chair is another (indicating); this house has no encumbrance on it whatsoever, it was just built, completed today; the purchaser of it paid \$10,000.00 for it, he wrote a check and paid cash. This house was also built today, made to the same plans and specifications, and the purchaser did not have \$10,000.00, but that is what he had to pay for this house, so he had to borrow \$8,000.00; he placed a mortgage on his house of \$8,000.00, put up \$2,000.00 cash, and paid off the seller of the house. Both houses are worth, fair market value \$10,000.00 today. What is this house worth?

A. Well, you just told me it was worth \$10,000.00. You said that is the fair value of it.

Q. What would you give for it?

A. I wouldn't buy it, but if it is worth \$10,000.00, then I accept that value.

Q. The house is there now and I am the purchaser. I don't have the \$10,000.00, so I go to the

(Testimony of Jonathan B. Lovelace.)

bank and borrow \$8,000.00 and put up \$2,000.00 of my own and buy it. Now, you were also a willing purchaser of that house, and before I bought it what was it worth? A. \$10,000.00.

Q. After I bought it what was it worth?

A. The house is worth \$10,000.00.

Q. How much would you pay me for my equity?

A. If you borrowed it for 2 per cent interest for 20 years [338] I might pay \$2,400.00 or \$2,500.00. If you borrowed it at 6 per cent for 5 years, I would pay you less than \$2,000.00, because you have done for me what I could do for myself. If you did a better job, I would pay you a premium.

Q. On what basis did you deduct 27½ per cent depletion as from the stipulated income to obtain the income you valued?

A. I wanted to get my earnings for the five year period on the basis comparable with the other securities, the securities listed on the New York Stock Exchange. The earnings were reported after taxes and after depletion and after amortization. Here is a company that, because of its being a family holding company, was following the policy of charging on its books very high depreciation and depletion in the earlier years and no depreciation in the latter years. I have referred to that before. The oil properties have a value estimated or appraised by a previous witness at \$3,000,000.00 That \$3,000,000.00 was the June 5 value of the oil they expect to get out in the future. In the last ten years the company has taken out more oil than it expects to take

(Testimony of Jonathan B. Lovelace.)

out in the next ten years, and yet in the year 1940 that capital asset, which is obviously becoming worthless as value is taken away from it, as oil is taken out, the remaining value is less, yet on the books of the company there was only charged off \$2,000.00 in the year 1940 because they had applied on the books a method of amortizing the [339] cost in the early years.

Now, the real value of any oil income is the earning power, is the income loss, the depletion loss, the amount that is required to charge that item off by the time it is exhausted, and the government allows a formula of $27\frac{1}{2}$ per cent for that purpose.

Q. Do you understand that that $27\frac{1}{2}$ per cent is tax free income?

A. I don't know the answer to that. I understand what is allowed is a depletion charge on which the company does not pay an income tax, or the corporation does not. In other words, the $27\frac{1}{2}$ per cent is an arbitrary figure the government adopted, I understand, to try to permit arriving at the real earnings of the company. Here the company which has an oil property on its books at no value, that is, stipulated at no value on the books.

Q. No; that is at issue.

A. Sir?

Q. That is at issue.

Mr. Mackay: It is on the books.

The Witness: No, on the books at no value, so you could not charge it off on the books if it was carried at no value. Now, obviously, there was de-

(Testimony of Jonathan B. Lovelace.)

pletion and we are appraising it to put a value on the books from June 5th. I don't know whether you put it on the books or not because that is a different [340] thing from the real earnings. If you place a value of \$3,000,000.00 on these oil properties at June 5, 1941, and that is a capital asset, that asset is going to be extinguished during the life of that royalty and has to be charged off so much per annum, and those charges are made against earnings. They may or may not be the precise charge that will be allowed by the federal government, but in order to get the picture of the earnings in the last five years, we had to apply a proper depletion charge to those earnings as they were stated before depletion to get at the real earning power.

By Mr. Melville:

Q. It is your understanding that in arriving at that value of \$3,000,000.00 they gave consideration to depletion of 27½ per cent?

A. No, I have no—I didn't make any study of that at all. I accepted the value.

Q. You don't know whether that value took into consideration 27½ per cent or not?

A. I don't know that. If it does——

Q. Do you know?

A. No, I do not know.

Q. But you arbitrarily have taken another 27½ per cent into account in figuring your——

Mr. Mackay: If your Honor please, I don't want to limit counsel's cross examination, but the witness has so many times said he did it for the purpose

(Testimony of Jonathan B. Lovelace.)

of comparison with other [341] companies, to get a comparison. Here are all the other companies, as he testified, which on their earnings show earnings after depletion, and this is done for the purpose of getting that comparison.

The Court: I am confused on this adjustment on the 27½ per cent depletion. I never got that straight in my mind as to what your theory is on that. Let the witness proceed.

Mr. Melville: I am just as confused, your Honor.

The Witness: I can explain it better by taking the situation from this point, your Honor. On the books of the company the oil property was carried at nothing. Therefore, on the books they could not deplete something that already was carried at zero. Nevertheless, there is obviously a wastage of assets. Now, if we take the situation from June 5th—I think I can explain it—if we put on the books—if we make a balance sheet of Dominguez and put on the books oil royalties at \$3,000,000.00, then by the time all the oil has come out of the ground underlying those royalties, that asset would have to be wiped off the books because it will have no value at the end of that time. So, the \$3,000,000.00 must be written off over the life of the lease.

It is stipulated as to what rate that oil royalty will come in. It is shown on Exhibit 11-K, for example, that in 1942 the company will get from its oil properties \$756,000.00, [342] and it says that up to 1965 it will get \$8,660,000.00, and after 1965 a small additional amount, so that the total royalties

(Testimony of Jonathan B. Lovelace.)

it will get will be something over \$9,000,000.00, \$9,299,000.00.

Now, if it gets back in the year 1942, \$756,000.00, in getting back in that year 8.37 per cent of the total amount of it is going to get back, and if you capitalize this royalty at \$3,000,000.00, then you would have to charge off 8.37 of that \$3,000,000.00 in the year 1942 to keep your books on a proper basis, so that by the time all the oil has come in, the way it is stipulated, you will have written off that value.

The Court: When you take the $27\frac{1}{2}$ per cent adjustment which is allowed simply to a taxpayer to receive that much income tax free, it seems to me that you are making an annual adjustment of $27\frac{1}{2}$ per cent instead of $8\frac{1}{3}$ per cent.

The Witness: $27\frac{1}{2}$ per cent of the oil royalties that came in that year. Let me follow just one step further. I could not do this with respect to the past because we had the record. I apply this 8.37 per cent to the \$3,000,000.00, and that would mean that the actual depletion or amortization required to write off that value would be \$251,000.00 in the year 1942, because that is 8.3 per cent of the total of \$9,000,000.00. Now, if I take that same oil royalty, \$756,000.00, and deduct $27\frac{1}{2}$ per cent of that, which was the arbitrary figure, the deduction would be something over \$200,000.00, so [343] actually the $27\frac{1}{2}$ per cent charge does not write it off as fast as you would be required to do it on the basis of stipulated figures.

(Testimony of Jonathan B. Lovelace.)

The Court: That is only fortuitous. It just happened.

The Witness: That figure was arrived at that way. That is my understanding.

The Court: I don't wish to interfere with the theory of counsel or the witness.

Mr. Mackay: That is all right, your Honor.

The Court: I was just trying to see if I understood it.

Mr. Mackay: We want you to.

The Witness: I am not trying to appraise the oil lands. I am simply saying these earnings as reported should be adjusted to compare them with securities on the New York Stock Exchange. Otherwise, if I were making a comparison in 1932, I would have this company reporting earnings of \$11.00 when the real earnings were a great deal higher.

By Mr. Melville:

Q. Is it your understanding, Mr. Lovelace, that you apply this 27½ per cent to income?

A. That is what I applied it to, yes.

Q. You did?

A. Yes, reduced the royalty income by that amount. [344]

Q. You did not apply it to anything else but royalty income? A. No.

Q. What figure did you use? \$3,000,000.00?

A. No, I took 27½ per cent of the income in that year and that is less than it would have been

(Testimony of Jonathan B. Lovelace.)

if you had capitalized it at the value we are talking about now.

Q. Did you apply the 27½ per cent to the \$3,000,000.00?

A. No. I applied the 27½ per cent in the case of the year 1940—put it this way—let me go back a minute. In the year 1932 this company reported earnings of \$119,000.00. Those earnings were after depletion of \$413,000.00. In that year they received an oil royalty of \$600,000.00. So, I said, to get on a comparable basis, that that \$600,000.00 of oil royalties should not have been depleted to the extent of \$413,000.00, as was done, but should have been depleted to the extent of \$165,000.00. That is 27½ per cent of those oil royalties. So, therefore, the earnings, instead of being \$11.00 or \$12.00 as reported, actually were around \$35.00 in 1932, because of the very heavy depletion. We come down to 1940 and the company shows earnings before depletion of \$4,990,000.00, with only \$2,000.00 deducted for depletion, and I said the depletion should be \$163,000.00, the same as it was back in 1932 and 1933 because the production was the same—\$183,000.00. Therefore, the earnings were understated in the [345] early part of the 10-year period and overstated in the latter part. I did not do this with any idea of appraising the oil stock. It was simply to get the earnings on the basis where it would be comparable with the reports made by listed companies with which I was comparing the investment opportunities.

Q. Now, then, on the income of the Dominguez

(Testimony of Jonathan B. Lovelace.)

Estate Company in 1940, is it your understanding that out of each dollar that they received—correction—out of each \$100.00 that they received, \$27.50 was tax free income and the balance was taxable income?

A. No, I didn't go into analyzing the tax status at all.

Q. Is that your understanding of the 27½ per cent depletion?

A. I have no understanding on the tax status of it. My interest is, at what rate should you allow for depletion of your assets, and thus for a return of capital? In other words, the earnings they reported in the later years included an element of return capital from the standpoint of the investor.

Q. I have had an understanding, right or wrong, of what percentage depletion meant, but I do not believe the record shows that you understand it. I wish you would define, if you can, what the expression "percentage depletion" means?

A. I don't feel in a position to define it.

Q. Well, do you know that percentage depletion deals with [346] a percentage of 27½ per cent?

A. That is the rate, yes.

Q. That is the rate. And you have been using that rate without knowing what it means?

A. I have been using that rate because it coincides with the approximate diminution of the value of this company's assets. I say this, that if a company receives \$600,000.00 from its oil in 1932, and receives \$600,000.00 for its oil in 1941, it is not

(Testimony of Jonathan B. Lovelace.)

reasonable to charge off—it is not reasonable for purposes of comparison to charge off \$400,000.00 in one year and only charge off \$2,000.00 in the other, and I took an arbitrary amount.

Q. So you are taking an arbitrary 27½ per cent just in order to be reasonable?

A. Yes, and I consider it fair. I restated the earnings to get them——

Q. You are not taking the 27½ per cent because it is the law but because it is reasonable? Is that my understanding of your testimony?

A. Yes.

Q. You don't know what it means?

A. I don't know precisely the implication on the tax return, no.

Q. Well, was the 27½ per cent that you took off income—— [347]

A. Income to whom?

Q. The Dominguez Estate Company.

A. That they received in 1932?

Q. Let us make this simple, Mr. Lovelace. Let us assume that the Dominguez Estate Company received \$100.00 in oil royalties, and we will just take it at \$100.00 because even a lawyer can understand the percentages in that case.

A. Yes.

Q. Now, they received \$100.00 income from oil royalties; apply your 27½ per cent to that, and what do we have?

A. We have 72½ per cent.

Q. What was that \$72.50 to the Dominguez Oil Company?

A. That is income.

Q. Income?

A. Net income.

Q. And what was the \$27.50?

(Testimony of Jonathan B. Lovelace.)

A. That is an amortization of the value of the property to allow for the depletion of its assets.

Q. Not income at all? A. No.

Mr. Melville: No more questions.

Redirect Examination

By Mr. Mackay:

Q. Now, Mr. Lovelace, I think you have stated that the companies which you made a comparison of—that in their [348] statements their earnings show, or their books reflect earnings after depletion, is that right?

A. After depletion and amortization.

Q. And then you were merely making this 27½ per cent deduction here for the purpose of comparing with these other companies?

A. That is right, and it appeared to me that the assets were being dissipated and were being used up at a greater rate than that, but I used that as a figure which I thought was a conservative figure to allow for it.

Q. But the main purpose was to put them on a comparable basis so you could make a comparison? A. Solely for that purpose.

Q. Now, Mr. Lovelace, do you know how long the Dominguez Estate Company has been in existence? A. Since 1910.

Q. It was organized in 1910? A. Yes.

Q. Do you know when the Carson Estate Company was organized?

A. Let me check. I have it. I remember reading it. It was 1914, I believe.

(Testimony of Jonathan B. Lovelace.)

Q. And the Francis Land Company?

A. 1928.

Mr. Mackay: I think that is all. [349]

Mr. Melville: I may wish to examine again. May I have a brief recess, your Honor?

The Court: Very well. We will suspend for a brief recess.

(A short recess.)

Mr. Melville: I believe you said you were through with the witness?

Mr. Mackay: Yes.

Mr. Melville: So is the respondent.

The Court: Very well, you may step aside, Mr. Lovelace.

(Witness excused.)

Mr. Mackay: Call Mr. McFie.

LYMAN R. McFIE,

called as a witness for and on behalf of the petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your full name for the record, please?

The Witness: Lyman R. McFie.

By Mr. Mackay:

Q. Mr. McFie, what is your occupation?

(Testimony of Lyman R. McFie.)

A. I am manager in Southern California of Merrill, Lynch, Pierce, Fenner & Beane.

Q. How long have you been manager? [350]

A. Since April 22, 1942.

Q. Prior to that time what was your occupation?

A. I was manager in Southern California for Schwabacher Company.

Q. That is a brokerage house?

A. Brokerage and investments.

Q. How long were you manager for them?

A. 12 years.

Q. How long have you been in the brokerage business, Mr. McFie? A. About 16 years.

Q. All that here in Los Angeles?

A. Yes.

Q. You have had occasion, have you, to value stocks of various companies? A. Yes, sir.

Q. Will you please give the court in a brief way your experience along that line?

A. I have acted as appraiser in underwritings of both stocks and bonds. We have acted as agents and brokers in stocks, bonds, commodities, and securities of all kinds.

Q. Has it been your duty to place values upon them from time to time? A. Yes.

Q. You have bought and sold, of course, many stocks and bonds, haven't you? [351]

A. Yes, sir.

Q. You were here and heard Mr. Lovelace testify, did you? A. Yes, sir.

Q. Particularly with respect to the general mar-

(Testimony of Lyman R. McFie.)

ket condition on June 5, 1941, or about that time?

A. Yes, sir.

Q. Would your testimony be substantially the same as his with respect to general conditions?

A. Yes, it would.

Q. Have you made an examination—I will withdraw that. Have you been furnished with a copy of the stipulation that has been presented here in evidence together with the exhibits?

A. Yes, sir.

Q. Have you made an analysis of those exhibits and stipulation?

A. Yes, sir.

Q. Have you formed an opinion as to the fair market value on June 5, 1941, of 200 shares of stock of the Carson Estate Company?

A. Yes, sir.

Q. Have you formed an opinion as to the fair market value of that same date of 100 shares of the Dominguez Estate Company?

A. Yes, sir. [352]

Q. And have you also formed an opinion as to the fair market value on that date of 500 shares of the Francis Land Company stock?

A. Yes, sir.

Q. Mr. McFie, you are acquainted in a general way with these various companies, are you not?

A. Yes, sir.

Q. They have been in existence a long time, haven't they?

A. Yes, sir.

Q. You are also familiar in a general way with their holdings?

A. Yes, sir.

(Testimony of Lyman R. McFie.)

Q. Their real estate holdings and their oil properties?

A. Not so much the real estate holdings.

Q. But you do know the real estate is located here in Southern California, and much of it in Los Angeles?

A. Yes.

Q. What basis did you use in determining the fair market value of the 200 shares of the Carson Estate Company stock, Mr. McFie?

A. I took the stipulated value and took the value of the oil royalties that were furnished by Mr. Paul Paine and divided them back into the Carson Estate Company.

Q. I think probably—— [353]

Mr. Melville: I don't want you to lead the witness.

Mr. Mackay: I am not leading the witness.

The Court: There is nothing to rule upon. You may proceed.

Mr. Mackay: I will withdraw that right now.

By Mr. Mackay:

Q. I would like to ask you—I think it would be better to go the other way—I will ask you what your basis was for determining the fair market value on June 5, 1941, of the 100 shares of the Dominguez Estate Company stock?

A. I used the stipulated value——

Q. You mean the value stipulated on the balance sheets, on the exhibits?

A. Yes. —for all properties other than the oil royalties. I used Mr. Paul Paine's estimate of \$3,-

(Testimony of Lyman R. McFie.)

000,000.00 as being the value of the oil royalties on that date.

Q. Why did you use Mr. Paul Jaine's figure?

A. Because I regard Mr. Paine, probably with Mr. de Golyer, as the two outstanding petroleum engineers in the United States.

Q. Has your company had occasion to use Mr. Paine from time to time?

A. No, we have never used Mr. Paine. We have never had occasion to use any petroleum engineers, but I have talked to a great many people who have used him.

Q. All right. Now, proceed. [354]

A. The stipulated value of Dominguez properties, excluding the royalty oil, was \$470.30.

The Court: Per share?

The Witness: Per share. Dividing the \$3,000,000.00 appraised value set on the oil royalties by Mr. Paine by the number of shares outstanding gave a figure of \$285.70.

By Mr. Mackay:

Q. Per share?

A. Per share, or a total appraised and stipulated value of \$760.00 per share on June 5, 1941.

The Standard Oil Company of California had a book value as of 12-31-41 of \$44.66 per share. The last sale on the New York Stock Exchange on June 5, 1941, was \$20.50. In other words, it sold at 45.9 per cent of its book value.

Union Oil on the same date had a book value of \$30.11, and the closing sale on the New York Stock

(Testimony of Lyman R. McFie.)

Exchange was \$13.75, so that it sold at 45.68 per cent of its book value.

These are both integrated companies, very aggressive and progressive. I could not certainly give a small, call it family or personal holding company, with their oil holdings in one field, incidentally situated right along one of our major earthquake fault lines in Southern California, and I have been told by an operator that damage has been done by earthquakes in that field—I could not give that company the same ratio to its appraised or stipulated value as I could companies of [355] the caliber of Union or Standard Oil Company, both listed on the New York, San Francisco and Los Angeles Stock Exchanges with a ready market at all times, with the stock held in practically every state in the Union and probably in every country in the world, so I took an arbitrary figure of 40 per cent of the \$760.00 per share, which set a value of \$304.00 per share on the Dominguez stock.

Q. Now, is that your opinion as to the fair market value of that stock on that date?

A. Yes, sir.

The Court: What was the figure again?

The Witness: \$304.00. That is 60 per cent discount from the \$760.00. I did not both with the few odd cents in there.

Taking that figure and dividing it back, taking the \$760.00 a share which was the stipulated and appraised value of Dominguez stock, dividing that back into the Francis Land ownership of 5,499

(Testimony of Lyman R. McFie.)

shares, it gave Francis Land Company an appraised and stipulated value of \$836.00 per share. Again taking a 60 per cent discount, it brought the value, in my opinion, on that date at \$334.40.

By Mr. Mackay:

Q. That is for Francis Land Company stock?

A. Francis Land Company. Now, taking the stipulated values and the appraisal of Mr. Paine on the Carson holdings, they owned 1,353 shares of Dominguez, and they owned 1,785 shares [356] of Francis, which in turn owned 5,499 shares of Dominguez, so that their proportionate holdings of the Dominguez stock owned by Francis figured at 1963.14 shares, so that directly and indirectly Carson owned 3,316.14 shares of Dominguez. The stipulated value per share of Carson, excluding oil royalties, was \$103.00 per share. Using the stipulated value of Dominguez properties, excluding the oil royalties, of \$474.30 per share, and multiplying and dividing it out, it gave Carson Estate Company a value of \$212.00 per share. When I say value, I mean appraised and stipulated. The Carson Estate Company, according to Mr. Paul Paine's appraisal of their oil royalties of \$283,000.00, was equivalent to \$38.00 per share, and the Carson Estate Company share of Dominguez Estate's oil royalties appraised by Mr. Paine at \$3,000,000.00 figured out \$127.00 per share, which gave the Carson Estate Company an appraised and stipulated value of \$480.00 per share. I took a 60 per cent discount,

(Testimony of Lyman R. McFie.)

which gave me a value of \$192.00 per share as the fair market value on June 5, 1941.

Q. Will you explain to the Court how you arrived at that 60 per cent discount in each one of those cases?

A. It is an arbitrary figure. I can conceive in my mind of stock in a family holding company, as I said before, with their oil properties located in one field, a company that is liquidating its resources, setting up no surplus but paying out more than they are earning, and I could not conscientiously [357] base that the same as I would Standard of California or Union of California, and, as I told you first, they were both selling at about $45\frac{3}{4}$ per cent of their book value.

Q. What consideration did you give to the earnings as shown in these stipulations?

A. If it had not been for the possibility of a fairly short pay-out, I will put it, rather than earnings, I would have reduced that from 60 to probably $66\frac{2}{3}$ per cent. For a person to buy this, in my opinion, to buy stock in Dominguez, Carson, or Francis, it simply is a guess as to how soon you get paid back. After you get it back your profit is in there.

Mr. Mackay: You may take the witness.

Cross-Examination

By Mr. Melville:

Q. Do I understand your testimony to be that

(Testimony of Lyman R. McFie.)

after arriving at the percentage—I will withdraw that question.

Tell the Court how you arrived at the 40 per cent, to begin with?

A. I did not and do not believe that the stock in the Dominguez Estate Company is worth as much or was worth as much on that date as stock in Union Oil Company of California or Standard Oil Company of California.

Q. And you took into consideration certain factors with respect to the Union Oil Company and the Standard Oil Company in arriving at a percentage, is that correct? [358]

A. I took the prices at which those stocks closed on June 5, 1941, and took the percentage of that market price to their book value.

Q. Book value of what? Their assets?

A. Their book value, all of their assets.

Q. Fine. Did you consider any other companies besides those two in arriving at or making this comparison to get a percentage?

A. Yes, I have a great quantity of figures. I left them at the office because Mr. Lovelace has furnished very much the same line that I would and I did not want to take up the time of the Court.

Q. That is all right, Mr. McFie.

A. I have here Atlantic Refining Company on that date, and at 12-31-41, it had a book value of \$63.66.

Q. When you say book value, you mean book value of its assets?

A. That is what book value is. It closed on the

(Testimony of Lyman R. McFie.)

New York Stock Exchange on that date at \$20.00, so that the last sales price was 31.2 per cent of its book value. U. S. Steel on that date sold at 47.7 per cent of its book value. Western Union sold at 12.7 per cent of its book value.

Q. I believe we can cut this short.

A. All right.

Q. In other words, you went right down a long list and [359] on the basis of all the companies that you studied, you made a comparison of the closing prices of their stock in the Exchange as of—what was the date? A. June 5, 1941.

Q. And you compared that with the book value of their assets as of what date? A. 12-31-41.

The Court: 1940, I suppose you mean.

By Mr. Melville:

Q. Did you mean 1940 or 1941?

A. My figure here shows 1941. It must have been 1940. These were taken from Standard Statistics, and the difference would be very minor, maybe \$1.00 or \$2.00 per share one way or the other, I think.

Q. But you don't know whether it was 1940 or 1941? Your figures you are reading from show 1941? A. They show 1941, yes.

Q. In considering all of these companies, now, you compared the selling price on the New York Stock Exchange, taking the close, and compared it with the book value of their assets as of December 31, 1941, and arrived at a percentage, averaged

(Testimony of Lyman R. McFie.)

them up, and you arrived at a percentage of 40, is that correct?

A. No, I took individual per cents. I did not average them. I took them individually as stocks. I also took into [360] consideration their dividends and their earnings.

Q. Just how did you get this figure of 40 per cent? Didn't you testify on direct examination that you took the prices at which the stock of Union Oil Company and the stock of Standard Oil—is that California? A. That is right.

Q. —sold on June 5, 1941, and compared that with the book value of the assets of those companies and you got a percentage in each case, and the average of those percentages was 40 per cent?

A. No. The two that I specifically paid attention to were Standard of California and Union of California, which, as I told you, was 45.9 in the case of Standard of California, and 45.68 in the case of Union of California. In my opinion there is no comparison between the stocks of Francis, Carson, or Dominguez to the stocks of Standard or Union of California, and if a customer came in my office and asked to purchase some oil stocks or royalty stocks, I would definitely have recommended that they buy Standard of California and Union of California rather than Dominguez, Francis, or Carson, even at the discount that I have taken.

Q. Now, you arrived first at a discount of 40 per cent? A. 60 per cent discount.

Q. Doesn't your testimony on direct examina-

(Testimony of Lyman R. McFie.)

tion after you get through talking about Union and Standard give a discount [361] factor of 40 per cent?

A. In the case of Dominguez, for instance?

Q. No, for these companies that you studied.

A. No, I gave a discount of practically 55 per cent. That is what they were selling at, 55 per cent off their book value, or 45 per cent plus a fraction of their book value. In other words, they were selling—we will cut out the fractions by way of explanation, and they were selling at a discount of 55 per cent from their book value or they were selling at 45 per cent of their book value.

Q. I am referring now to the work sheet that you have before you, and I call your attention to a list of percentages which starts off with Standard Oil at 45.9; Union Oil, 45.68; Atlantic Refining, 31.2; U. S. Steel, 47.7, and so forth. When you got all through did you add those and take an average of them? A. No, sir.

Q. You did not testify, then, as to any 40 per cent discount in this case either with respect to these companies or with respect to the Dominguez Estate Company?

A. If I did, it was a slip of the tongue. The discount in the case of these companies, Standard and Union, is roughly 55 per cent. In the case of Dominguez, Francis, and Carson, it was 60 per cent.

Q. All right. [362]

(Testimony of Lyman R. McFie.)

A. In other words, they sold at 40 per cent or 45 per cent of their book value.

Q. They sold at 40——

A. 45 per cent of their book value.

Q. I guess that is probably what I had in mind.

A. You got the per cent rather than the discount.

Q. All right. If these companies that you analyzed sold at 40 or 45 per cent of their book value, then the discount would necessarily be 60 or 55 per cent from their book value——

A. That is right.

Q. ——to arrive at the sales price?

A. That is right.

Q. Now, did you read from that, then, that since Dominguez Estate Company stock is worth not as much, being a closely held family corporation——

A. With one market.

Q. With one market. ——it is not worth as much as these stocks, and therefore instead of taking as in these stocks a discount of 55 or 60, you took the maximum of 60, is that correct?

A. That is right.

Q. And off of what figure, then, did you take the 60 per cent? The book value?

A. Off of the appraised and stipulated value, which I [363] am saying for intents and purposes is——

Q. The same as book?

A. No, I think book value would be higher, and in the case of the Standard and Union of Califor-

(Testimony of Lyman R. McFie.)

nia, I would say that book value is very much lower.

Q. What about the book value and appraised value in our case?

A. You have stipulated a value on everything except the oil royalties, and I am relying upon Mr. Paine's judgment——

Q. As to them?

A. ——and appraisal as to the value of those.

Q. What is the total figure that you applied your 60 per cent to in arriving at your estimate or opinion of the fair market value of Dominguez Estate Company stock?

A. I took a discount of 60 per cent from an appraised and stipulated value of \$760.00 per share.

Q. Where did you get your \$760.00 per share?

A. I gave that in direct examination, but I will give it again. The per share value of Dominguez, excluding oil royalties, is stipulated at \$474.30.

Q. How did you arrive at that? Go back to that, please.

A. It was furnished to me by Mr. Mackay.

Q. Did he furnish you——

The Court: What is that? Is that the sum of those items shown there on Exhibit 1-A divided by the number of shares [364] of stock? Is that correct?

The Witness: I believe that is right.

By Mr. Melville:

Q. Which column?

The Court: The last column of 1-A?

(Testimony of Lyman R. McFie.)

The Witness: I haven't 1-A before me.

The Court: This is it here (indicating). Is this what you did, add these four?

The Witness: No, I was given the figure.

By Mr. Melville:

Q. You were given the figure? Have you ever seen this exhibit or a copy of it? A. Yes, sir.

Q. If these figures were added up and divided by the number of shares outstanding, it would give you the figure down here that you used?

A. I think so, yes, sir.

Q. Why didn't you use the book value figures?

A. Because I could not rely upon the book value figures on Dominguez as well as I could the book value figures of Standard and Union. I don't know how Dominguez kept their books except by looking over the manner in which they took depletion. I was satisfied that their books were not on the same basis that Standard and Union would keep their books. An appraisal, in my opinion, of Standard or Union would show a [365] very much greater value than these book values which I have used.

Q. Whose appraisals and for what purpose?

A. Well, it is a tremendous job to appraise, but I do know of some of the properties that they have bought in which they have not capitalized, according to some of the officers of the company.

Q. In considering these various companies, now, Mr. McFie, you don't have any knowledge or even an opinion as to the fair market value of their assets, do you? A. No, sir.

(Testimony of Lyman R. McFie.)

Q. You took their book value?

A. Which companies are you referring to?

Q. These on your work sheet.

A. Will you repeat that question?

(The question was read)

Q. I might clarify that for you.

A. By "these companies" you mean——

Q. Standard Oil and right down the list, not the Dominguez Company or the Carson Estate Company or the Francis Land Company, but the other companies that you considered and with which you make comparisons.

A. I know what the market value is.

Q. Market value of what?

A. Of Standard, Union, Atlantic Refining, et cetera. [366]

Q. The market value of their stock?

A. That is right.

Q. But you don't know the fair market value of their assets? A. No.

Q. And, therefore, you used the book value?

A. That is right because I——

Q. In our case you have both the book value and the agreed fair market value before you, but you chose to take your 60 per cent discount from the agreed fair market value, isn't that right?

A. The stipulated——

Q. Isn't that right?

A. I will have to explain.

Q. Answer the question yes or no and then explain. A. Yes.

(Testimony of Lyman R. McFie.)

Q. That is right? A. That is right.

Q. Now, you may explain.

A. The book value of these different companies, Carson, Dominguez, and Francis, was greater than the stipulated modern, up-to-date appraised value according to the figures furnished me. The manner of taking their depletion was such that I do not believe their book value reflects a fair value. As a matter of fact, your stipulated values in all cases were considerably [367] less than their book values. In the cases of Standard and Union, I know that their intrinsic value of fair market value of assets would be greater.

Q. It is stipulated, Mr. McFie, that the book value of Dominguez Estate Company's assets, not counting oil properties, was on May 31, 1941 \$9,803,763.11—I can correct it—\$9,564,346.61. That does not include anything for oil properties. If you add \$3,000,000.00, which is the appraised figure that Mr. Paine furnished you to that, you will have \$12,564,346.61. Why wouldn't it be fair to take 60 per cent of that rather than 60 per cent of our stipulated fair market value figures?

A. Because I don't think the book values were anything like being correct.

Q. Did you inquire into the correctness of the book values of the Standard Oil Company and the Union Oil Company, and so forth?

A. I made a tentative offer for the Union Oil Company of \$35.00 a share and was laughed at. I have been told by officers of the company and I

(Testimony of Lyman R. McFie.)

have been told by petroleum engineers that they considered the book values of both companies were very low.

Q. You are basing your opinion, then, on hearsay?

A. And definite information. Standard of California, for instance, are carrying their foreign holdings at cost less depreciation. They have not given any reflection whatever to [368] the discovery in Saudi Arabia. They own a half interest there of 47 outlying structures, producing from five, and so far have not gone far enough in the five to be able to engineer the reserves, and I have been told by the vice-president of the Standard Oil Company of California, and likewise the Texas Corporation, who own the properties jointly, that the first structure has a reserve of 1,000,000,000.00 barrels, the second one 5,000,000,000.00 barrels, and that is not reflected in their book value of \$44.66.

Q. Did you value the Francis Land Company stock and the Carson Estate Company stock in the same way that you valued the stock of Dominguez?

A. Yes, sir.

Q. You know, don't you, that there are a number of oil royalty companies in California?

A. I imagine there are.

Q. But you did not consider them in making your comparison?

A. We do not sell oil royalties. Our firm does not permit it except as an agent. When a customer desires to buy oil royalties through us, we have them

(Testimony of Lyman R. McFie.)

sign a statement to the effect that it was unsolicited.

Q. But aren't there oil royalty companies in California which have stocks that are traded on the market?

A. I don't know anything about that, sir. [369]

Q. You don't know that? A. No, sir.

Q. Then you did not consider such companies in making your comparison. A. No, sir.

Mr. Melville: That is all.

(Witness excused.)

The Court: Very well, we will suspend until 2:00 o'clock.

(Whereupon, at 12:30 o'clock p. m., a recess was taken until 2:00 o'clock p. m., of the same day). [370]

Afternoon Session. 2:00 p. m.

Mr. Mackay: Call Mr. McCuen.

C. MELVIN McCUEN,

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Will you state your name for the record, please?

The Witness: C. Melvin McCuen.

By Mr. Mackay:

Q. What is your address, Mr. McCuen?

(Testimony of C. Melvin McCuen.)

A. 621 South Spring Street.

Q. How long have you practiced as an investment counsel in Los Angeles? A. 14 years.

Q. How long have you engaged continuously and exclusively in analyzing securities for investment purposes? A. Since 1923.

Q. How many clients do you serve on a fixed fee annual basis? A. 32.

Q. Approximately how much capital do you manage or supervise? [371]

A. Approximately \$9,000,000.00.

Q. In how many cases have you appeared as an expert witness before the Tax Court?

A. In five.

Q. Have you determined the fair market value of the Dominguez Estate as of June 5, 1941?

A. I have, sir.

Q. What is your opinion as to the fair market value of the stock of the Dominguez Estate Company on June 5, 1941, particularly the 200 shares that are in question here?

Mr. Melville: I object, your Honor. Just a minute, Mr. Mackay. I would like to ask a few questions preparatory to a possible objection.

Mr. Mackay: All right.

Mr. Melville: Mr. McCuen, have you ever had any experience in valuing oil royalties.

The Witness: Not specifically oil royalties.

Mr. Mackay: I should have laid a better foundation for that with Mr. McCuen.

(Testimony of C. Melvin McCuen.)

Mr. Melville: Do you want to proceed again?

Mr. Mackay: Yes.

By Mr. Mackay:

Q. Have you been furnished, Mr. McCuen, with a copy of the stipulation that has been filed in court here? A. I have. [372]

Q. And also the exhibits attached thereto?

A. Yes.

Q. And have you made an analysis of those exhibits? A. I have, sir.

Q. And you have formed an opinion based upon the information therein contained, together with your background or experience, have you?

A. Yes.

Q. Now, those exhibits, I think, stipulate the fair market value of all the assets of the Dominguez Estate Company except the oil royalty interests. What figure do you use there, Mr. McCuen.

A. In the computation on the fair market value of the oil royalty assets I have used the estimate of value of the appraisal by Mr. Paul Paine.

Q. And why did you use that?

A. Well, I was for six years the statistician and analyst for Dean, Witter Corporation, and from my knowledge of his general reputation and standing for integrity and ability and success, I feel very safe and confident in accepting his valuation. Of course, I also checked his valuation against other evidence that seemed to indicate that that was a very reasonable and sound valuation.

Q. What did you check with?

(Testimony of C. Melvin McCuen.)

A. Well, at that time the oil assets of leading producing [373] companies in California and the United States sold for about 35 to 40 cents per barrel. Some oil companies, such as Superior Oil Company, sold as low as 18 cents per barrel. If you take about 35 or 40 cents per barrel for the estimated number of barrels that were in the Dominguez Estate here, you will arrive at a value of around \$3,000,000.00.

Q. \$3,000,000.00? A. Yes, sir.

Q. Now, will you please tell the Court how you arrived at the fair market value of \$380.00 per share for the Dominguez Estate Company on June 5, 1941?

Mr. Melville: I am sorry, but I did not know he testified to that.

By Mr. Mackay:

Q. Didn't you? I beg your pardon.

Mr. Melville: I move that it be stricken.

The Court: He has not stated what he thought the value was.

By Mr. Mackay:

Q. What, in your opinion, was the fair market value?

Mr. Melville: I object.

The Court: Wait a moment. We are all talking at once. The reporter cannot get it. Have you completed your question, Mr. Mackay?

Mr. Mackay: No, your Honor. [374]

The Court: You may proceed with the question.

By Mr. Mackay:

Q. What, in your opinion, was the fair market

(Testimony of C. Melvin McCuen.)

value on June 5, 1941, of the 200 shares of capital stock of the Dominguez Estate Company?

Mr. Melville: I object, your Honor.

Mr. Mackay: I beg pardon. 100 shares.

The Court: Just a minute before the witness answers. What is your objection?

Mr. Melville: My objection, your Honor, is based on the fact that the witness has testified that he is basing his opinion in part on the opinion of Mr. Paine and he is not qualified himself to form an independent opinion as to the fair market value of the oil royalties, and they must be taken into consideration in making any estimate of the value of the stock of the Dominguez Estate Company.

The Court: Well, the witness has testified that he used the figure which Mr. Paine had supplied and that he himself checked that figure with some other oil companies or records that he had.

Mr. Melville: I believe your Honor will recall, though, that he also testified that he has had no experience in valuing oil royalties.

The Court: Well, your objection goes more to the weight, I think, to be given to the testimony. We will permit [375] him to answer the question which has now been asked.

A. In my opinion, the fair market value of the Dominguez Estate Company on June 5, 1941, was \$380.00 per share.

By Mr. Mackay:

Q. Will you please tell the Court how you arrived at that value?

(Testimony of C. Melvin McCuen.)

A. Well, I, of course, carefully studied the income statements and balance sheets for ten years back and I studied carefully the stipulated value between the Petitioner and the Respondent, and, as I stated, I accepted the estimated appraised value of the oil royalty assets by Mr. Paul Paine at \$3,000,000.00, and that gave a total asset value of \$7,979,700. Now, this value of \$380.00 I tested against the assets and the earnings of the Dominguez Estate in the light of the distributions made and the limited market of the shares of this personal holding company. I have also tested this value in relation to the prevailing price of capital as of June 5, 1941, and after comparison with the market prices of oil and other shares prevailing in Los Angeles as of the basic date. Now, I think the price of capital is a very important consideration because the fair market value of any type or character of security is regulated by the price of capital. Some investors weight this economic factor more carefully than do others, but all consider the relative earnings and the prevailing return on invested capital, and investors seek the employment of capital in that market which offers the greatest income consistent with the demands of the investor with respect to safety, type and character.

Now, what was the price of capital on June 5, 1941? On this date we find the following yields on the various types of fixed income securities: Long-term Government Bonds yielded 2.3 per cent: highest grade long-term corporate bonds, 3 per cent;

(Testimony of C. Melvin McCuen.)

good grade corporation bonds, 3.6 per cent; highest grade corporate preferred stocks, 4 per cent; and good grade corporation preferred stocks, 4.75. The long-term interest rate is not only the foundation for the price structure of all long-term fixed income investments, that is, bonds and preferred stocks, but it is also the basic starting point in the analysis of valuation on equities or common stocks. However, in the case of common stocks, the analyst must deal with earnings as well as with the dividend yield. I think the prospective willing buyer and seller would have considered the earnings of the year 1940 more representative of the probable immediate future years' earnings than any other year or series of years of the past. The earnings of the Dominguez Estate Company in 1940 of \$47.27 compares with the average of \$51.35 for the ten years ended in 1940. The trend of earnings was down. The 1940 earnings were slightly less than one-half of those reported in 1936, and the earnings for the full year of 1941 of \$47.91 were indicated by the results of the first five months [377] of 1941. Furthermore, the earnings for 1940 of \$496,282.00, or \$47.27 per share, appear to be the most probable future earnings in relation to the estimated production and earnings curve for the major life of the royalties.

I asked myself how much these earnings were worth. In my opinion they were not worth more than 12½ per cent, capitalization basis, that is to say, 8 times earnings, and those earnings of

(Testimony of C. Melvin McQueen.)

\$496,282.00 were before any real deduction for depletion.

Now, on June 5, 1941, the 30 Dow Jones Industrial stocks, the best known American stock averages, and I have chosen that because it was taken without hindsight information, it was an average which had been computed and available and it was the barometer of general common stock values prevailing at that time—this was at 118.13 in relation to the 11.68 earned per composite share in 1940, or the Dow average sold for approximately 10 times 1940 earnings, and it also sold for 11.8 times the five-year average earnings for the period ended in 1940.

The three oil companies used in this industrial composite, that is, the Standard Oil of California, the Standard Oil Company of New Jersey, and the Texas Company, were also selling for 10 times their average five-year earnings for the period ended in 1940.

Of course, the earnings of the 30 industrial corporations [378] used in the Dow-Jones Industrial average were after deduction of depreciation and depletion. In using and multiplying 8 times earnings for the Dominguez Estate Company before depletion I am actually appraising these earnings at more than 10 times after what would have been considered a normal depletion for that corporation. I feel reasonably sure in stating that I do not believe anyone would have appraised the common stock risk of the Dominguez Estate Company on

(Testimony of C. Melvin McCuen.)

June 5, 1941, at a higher price than he would have valued the composite of the 30 Dow-Jones Industrials which are higher grade investments, or the 3 stocks used in the Dow-Jones Industrial average.

Furthermore, the shares of 14 well-known, actively dealt in, oil producing corporations in the California markets were selling for 7 times the 1941 earnings before depletion. Such a list contains Amerad, Barnesdale, Kern County Lands, Superior Oil.

Now, 8 times \$47.27 per share for the Dominguez Estate Company is equal to \$378.16. As I testified earlier, in my report, I found the asset value to be \$760.04. However, these assets as per the stipulated values and the appraised value of Mr. Paul Paine were not producing earnings to support a market value of \$760.00 per share. Inasmuch as the problem, as I see it, in this case, is to value the shares of a minority interest which has no power to liquidate the assets, it is my [379] opinion that the market value of this stock is best tested against the probable earnings of the future rather than against the asset value, because where no liquidation is indicated, the stockholder or prospective stockholder is more interested in the earning power of the business than in buying at asset position. It is interesting to note that at June 5, 1941, the two major California oil companies sold for less than one-half of the December 31, 1940, book value, that is, the Standard Oil of California and the Union Oil sold for about 46 per cent of their book

(Testimony of C. Melvin McCuen.)

value assets. Not only were oil assets depressed in the Los Angeles market on June 5, 1941, but assets of our leading banks sold for very substantial discounts. The market price and book values of two of the large local banks, in splendid financial condition, were as follows: Citizens National Trust and Savings had a book value of 41, and it sold for 24 or 59 per cent of its book value, which was composed largely of Government Bonds and a real estate asset which has been written far down. The California Bank at a book value of \$46.00 per share, and a market price on June 5, 1941, was \$25.00, so it sold for 54 per cent of its book value.

In the light of the prevailing discounts in relation to book value at which our leading oil, industrial, utility, and bank shares sold on June 5, 1941, I doubt if the assets of the Dominguez Estate would have sold for more than 50 per [380] cent of the stipulated and estimated book value, for \$380.00 per share. The ranch and real estate assets were a drag on the earnings because the expenses of servicing these assets exceeded their income. The market on June 5, 1941, discounted the net working capital and investments of our leading companies.

Furthermore, it would have been logical to assume that the willing buyer and willing seller would have bought and sold the shares of this stock on the basis of book value. I have continually kept in mind the liquidating nature of the business of the Dominguez Estate Company, and therefore have taken into full account the distributions and

(Testimony of C. Melvin McCuen.)

dividends of \$72.00 paid in 1940. Of course, such distributions were far in excess of the earnings of \$47.00 and odd cents. Such distribution represented not only a return on investments, but also a return of capital.

Marketability is so essential a factor, and so importantly so in the fair market value of shares of common stock, that it cannot be ignored but should be fully reckoned with in computing the fair market value of any share of common stock. It is my opinion that of two given securities assumed to be identical in every respect other than marketability, if one possesses no marketability at all and the other a high degree of marketability, the latter security will enjoy a market value of at least 15 per cent or more higher than [381] the fair market value of the former.

So, after considering the earnings as reported and the assets as per the stipulated value and distributions and the marketability, I think that a fair price that both would have agreed upon, that is, the buyer and the seller, the prospective buyer and seller, would have been \$380.00 per share.

Q. Mr. McCuen, I think you mentioned the Standard Oil and Union Oil of California. Did your analysis of either one of those companies' statements disclose any estimated oil reserves?

A. Well, the estimated oil reserves of the Union Oil at the end of 1940 are figured at 300,000,000 barrels. Now, the market price of Union Oil on

(Testimony of C. Melvin McCuen.)

June 5, 1941, was, I think, \$64,161,000.00, and they had——

Q. Did you say \$63,000,000.00?

A. \$64,161,000.00.

Q. I see.

A. They had net working capital of excellent composition and their investments and buildings, less the debt on those buildings, were \$63,172,000.00. In other words, all the 300,000,000 barrels of oil in the ground from this conception of value you could have gotten for nothing. All you were paying for in buying the Union Oil Company as of this date was for the assets above the ground.

Q. Now, Mr. McCuen, have you also formed an opinion as [382] to the fair market value of the Francis Land Company shares at June 5, 1941, and particularly the 100 shares in dispute?

A. I have, sir.

Q. What is your opinion as to the fair market value of that?

A. In my opinion the fair market value of the Francis Land Company was \$375.80 per share.

Q. How do you arrive at that?

A. Well, there was a little different approach to the estimation of the fair market value of the Francis Land Company as compared with the Dominguez Estate Company in that the Francis Land Company is essentially a holding company. It held practically 1.1 shares of Dominguez Estate common stock for each share of common stock that it had outstanding, and it had no other substantial

(Testimony of C. Melvin McCuen.)

assets, and of the other assets it had, their total value was exceeded by the total current liabilities of the company.

Now, I believe as a holding company that the shares of that stock would have been discounted by at least ten per cent. In other words, taking the estimated value of \$380.00 per share for the Dominguez Estate, you get a valuation of \$417.55 per share for the Francis Land Company, but I do not believe the buyer would have bought nor the seller would have demanded the full indicated book value as per that appraisal on the Dominguez because the Francis Land Company was subject [383] to taxes, and the Dominguez stock in the Francis Land Company was further removed from the stockholder than if he had bought the Dominguez Estate Company stock outright. Therefore, I subjected it to a nominal discount of 10 per cent. I am reasonably sure that it would have been at least 10 per cent, and it may have been higher.

Q. Have you also formed an opinion as to the fair market value of the stock of the Carson Estate Company, the 200 shares given away on June 5, 1941? A. I have, sir.

Q. What is your opinion as to that?

A. In my opinion the fair market value of the Carson Estate Company as per the stipulated values, and taking the Francis Land Company stock at \$375.80, produces a total value of \$2,231,340.00 for the Carson Estate Company. When you divide that by 7,412 shares of common stock

(Testimony of C. Melvin McCuen.)

outstanding, you get a book value as per those stipulated and estimated values of \$301.00 per share, and I deducted 20 per cent from that value and arrived at a fair market value of the stock of the Carson Estate Company of \$240.80. The Carson Estate Company, while it had other assets than the Dominguez Estate stock and the Francis Land Company, those assets were not particularly productive, and I think—in fact, their expenses exceeded their income—and I think that would have been viewed as any investment trust share or any holding company stock. Now, on [384] June 5, 1941, I find such splendid holding company stocks, that I think had far better underlying assets in them, as Christiana Securities. That is the top holding company that controls the General Motors and the DuPont Company. Now, the book value of that stock on December 31, 1940, was \$3,263.00. It sold for \$2,360.00, or at a discount of 27.7 per cent. Lehman Corporation had a book value on December 31, 1940, of \$29.64, and its market value on the New York Stock Exchange on June 5, 1941, was \$20.75. The discount from book value was 29.3 per cent.

The Security Company, a well-known holding company listed but not so actively traded on the Los Angeles Stock Exchange, but there is always a bid and offering price not so far apart, had a book value of \$40.36, and it sold for \$30.00, or the reasonable spread between the bid and asked would

(Testimony of C. Melvin McCuen.)

have been \$30.00, and that therefore sold at a 38 per cent discount.

It should be evident that the fair market value of any investment or holding company share of stock is not necessarily the equal of the net assets or book value of the assets divided by the total number of shares. Such companies have to pay income taxes and are subject to management and administrative expenses that detract from the underlying value of the assets.

So, I think, in view of the discounts that such splendid investment or holding company stocks sold at, that [385] a discount factor of at least 20 per cent would have been agreed to by both the willing buyer and the willing seller of the Carson Estate Company as of the basic date.

Q. I think you mentioned—I want to make sure—in considering the asset value there—I will withdraw that.

In forming your opinion as to the fair market value of the Carson Estate Company stock, you did accept a certain value for the oil royalties? That is right? A. Well, I——

Mr. Melville: I object. That is leading.

Mr. Mackay: I think it is.

The Court: The objection will be overruled.

The Witness: I accepted your stipulated value of the Petitioner and Respondent of \$285,000.00.

Mr. Mackay: O. K. That is all. You may take the witness.

(Testimony of C. Melvin McCuen.)

Cross Examination

By Mr. Melville:

Q. Mr. McCuen, you stated that in valuing the stock of a personal holding company you took into consideration the fact that that personal holding company has income taxes and administration expenses and therefore the value of its stock must be somewhat less than the proportionate part of the assets? Is that your view?

A. No, I don't think—are you referring to when I [386] valued the Francis Land Company?

Q. It was toward the past part of your testimony. You said you took income taxes and administration expense into account. Now, please tell us about that?

A. Oh, yes. Well, you see, for instance, if you buy a group of corporation stocks listed on the New York Stock Exchange and you form a corporation and hold those, you will have to pay administrative and management expenses of the holding corporation there, and, of course, that detracts from the value of the underlying assets of that holding corporation.

Q. Now, Mr. McCuen, if you had \$500,000.00 and you were wondering in your own mind whether you would be better off to form a personal holding company, and after giving it some thought you decided to form a personal holding company and issued 5,000 shares of stock worth \$100.00 a share, you have this \$500,000.00 now invested in market-

(Testimony of C. Melvin McCuen.)

able securities and as of a given date your marketable securities are worth, let us say, \$500,000; what is the value of your stock per share?

A. The book value or the fair market value?

Q. The fair market value.

A. Well, of course, I don't know that I could answer that. I would want to know the corporation and its assets.

Q. It is your personal holding company. You know all about it. [387]

A. No, I do not, only the very few words you said about it. I would say that the book value would be, of course, \$100.00 per share as a going concern. If it was the intention to liquidate that corporation, you certainly would not get \$100.00 per share from that corporation from the assets if they had the value you indicated with the number of shares of common stock outstanding.

Q. Now, supposing I came to you and I said, "Now, I have got the money to invest and I think you know quite a bit about the securities market. You have got \$500,000.00 invested in marketable securities and I will bet my money that you made a good choice, that you have got your money pretty well spread"—diversification, I believe you call it—"so, rather than for me to go out and put my money in marketable securities, I would like to buy a few shares in your personal holding company." How much would you sell them to me for?

A. Well, if I were thinking of it from a selfish standpoint, I would naturally try to get as much

(Testimony of C. Melvin McCuen.)

as I could, but I would inform him that he could go out and buy common stocks of the very finest investment trusts or holding companies at about a 30 per cent discount. Then if he was willing to pay me \$100.00 for my stock as per the indicated book value, then of course he would have bought after being fully informed. It would probably have been worth that much to me if I owned all the stock and had the power of liquidating that corporation, but I do not think it would have been worth that much to the willing buyer because he could have gone out and bought other assets, unless I had particularly demonstrated myself that I could do very much better with those assets than the other investment trusts or holding companies were doing. Very few corporations do better than Lehman Brothers and Christiana Securities because DuPont and General Motors out-perform the averages.

Q. Let us get back to your personal holding company now. You tell me that you doubt very much that that stock would be worth \$100.00 a share to me? A. To the buyer.

Q. To me? I am the prospective buyer now. You are the one that owns the stock. You would be foolish to sell it to me for less than \$100.00, wouldn't you?

A. If I owned all of it and controlled the corporation it ostensibly would be worth \$100.00 a share to me.

Q. Would you or would you not sell me a share for less than \$100.00?

A. That is very difficult to answer.

(Testimony of C. Melvin McCuen.)

Q. I know I am making it difficult for you.

A. It is too hypothetical and it is not as specific as the problem we have here. We have all the facts of this case at hand and we have not all the facts of this other.

Q. But we are valuing a closely held corporation. Now, [389] there is nothing too difficult about the question I asked you. It seems to me that you should be able to answer my question yes or no. You either would or would not be willing to sell me 100 shares of——

A. I probably would not want to sell you the stock.

Q. All right. And you think that I would be foolish to pay you \$100.00?

A. I do if on the basic date you could have bought other leading investment trust shares at a 30 per cent discount, shares of proven merit and distinction in such companies as those which I have referred here.

Q. Now, when the willing buyer will only pay so much and the willing seller will not come down and they do not meet, there is no sale, is there?

A. That is right.

Q. So in this particular case you would be foolish, as I understand it, to sell me your stock for less than \$100.00, and, therefore, if I was willing, I would not buy it?

A. You would not pay \$100.00 for it if the same condition prevailed as on this basic date.

Q. Now, then, you decide to continue on owning

(Testimony of C. Melvin McCuen.)

the stock in this personal holding company; you have income taxes and administration expenses, do you? A. Yes.

Q. Now, the very fact that you continue this personal [390] holding company and pay these administration expenses and income taxes, doesn't that pretty well indicate that it was to your advantage to do so rather than to liquidate and take your money out?

A. It either was to my advantage or I had high hopes for the future enhancement of the value of those stocks.

Q. Oh, but you could still take the stocks out. This Dominguez Estate Company could distribute in kind, couldn't they?

A. Not as I understand it. We are evaluating a minority interest here who were powerless to do it. Of course, if I was called upon to evaluate a majority stock interest here, I assure you that I would have an entirely different answer than I have now.

Q. Let us go back, now, to the mathematics of arriving at your fair market value figure for the Dominguez Estate Company. You gave a figure of \$760.04. What was that?

A. That was the stipulated value of the net working capital, of the stocks and bonds, of the ranch and other real estate as per the stipulated value, plus the \$3,000,000.00 estimated value of the oil royalty by Mr. Paul Paine, making a total of \$7,979,700.00, and dividing that by 10,499 shares

(Testimony of C. Melvin McCuen.)

you get a book value of indicated fair market value from the asset standpoint of \$760.04. [391]

Q. Then I believe you took a discount from that? A. No, sir.

Q. Well, in the case of Francis you arrived at a—withdraw that question.

How did you go then? What was your next step after arriving at \$760.04?

A. I next tested the earnings to find what the value of the stock would be from the earnings standpoint. I believe the earnings standpoint for all going concern corporations generally should be accorded the greatest consideration, more than any other factor, that is, the factor of earnings, of assets, of dividends, or marketability. Those are the four cardinal factors in evaluating a common stock. I took the earnings of \$47.27 for 1940 because I believed that the year 1940 was the best norm year we could arrive at. If you multiply that by 8, and multiplying by 8 is equal to a capitalization ratio of $12\frac{1}{2}$ per cent, you will get a value of \$370.00, I think. To be exact, it is \$378.16.

Q. And from \$378.16 you made a round number of \$380.00?

A. No—somewhat, if you want to call it a round number. I thought, as I tried to demonstrate, that on June 5, 1941, very few corporations sold about the asset value because things were at a discount. I need not here rehearse the prevailing sentimental condition regarding world-wide military affairs and political considerations and tax considerations, and

(Testimony of C. Melvin McCuen.)

all of those. [392] It was an uncertain period. The stock market had already been on the drop from 1939 of around 156 to where it was down to 118, and there wasn't anything to indicate that the trend was going to stop at that time. So, assets sold at a discount, particularly here in L. A.

Q. All right. Then, did you discount the assets in this case?

A. I said, in view of the fact that our leading corporations, such as the Standard Oil of California and the Union Oil, the California Bank, and the Citizens Bank—that those assets sold on an average of about 50 cents on the dollar, and I don't believe anyone would have paid a higher price or ratio for these assets in the Dominguez Estate.

Q. If you take——

A. If you take 50 per cent of \$760.00, you get \$380.00 which bears out my earnings factor figures of \$378.16. So, instead of expressing it as \$378.16, I resolved it to a round figure of \$380.00.

Q. All right. Now, on Francis you followed the same procedure, as I understand it?

A. No. Francis was an entirely different——

Q. I think probably I should make that more explicit. In Francis, as I understand your testimony, you took what you estimated to be the fair market value of Dominguez stock and transplanted it into the balance sheet of Francis—— [393]

A. That is right.

Q. ——converted that into value per share of

(Testimony of C. Melvin McCuen.)

assets, and took a 10 per cent factor, and arrived at \$375.80? A. Yes, sir, that is correct.

Q. Then, in order to arrive at the value of Carson, you took the Dominguez stock at \$380.00, put that into the balance sheet, you took the Francis stock at \$375.80, and put that in the balance sheet, added them up, determined what the asset value per share was, and took a 20 per cent discount?

A. That is correct.

Q. Now, Mr. McCuen, that gives you in so far as the assets of the Carson Estate Company are concerned, a 50 per cent, which is what you took in Dominguez, and 10 per cent, which is what you took in Francis, plus a 20 per cent which you took in Carson. 50, 10 and 20 and 80 per cent that the assets of the Dominguez Estate Company are discounted by the time they are reflected in the fair market value of the Carson Estate Company? Isn't that your testimony?

A. It would appear that way but it is not exactly that simple, sir, for the reason that I did not value the Dominguez Estate Company primarily on its asset value. I took all the factors of valuation into consideration, that is, the earnings factor, the dividend factor, the marketability factor, and the asset factor. Now, if it happened to coincide with 50 per cent of the asset value, that is more of a coincidence of figures [394] than a method of valuation.

Q. Well, then, after having discounted the Francis assets at 10 per cent to arrive at the fair

(Testimony of C. Melvin McCuen.)

market value of Francis stock, why after you carry that stock into Carson Estate Company do you subject it to another 20 per cent discount?

A. Well, for the same reason that if you were to buy the stock of the Christiana Securities Company and the stock of the Lehman Corporation and the stock of the Security Company, or the stock of the State Street Investment Company, or any number of investment companies, and you want to form another corporation to hold those stocks, those stocks in my opinion would still sell at a further discount factor. Everyone does it. It is the method of a fair appraisal of such corporations.

Q. Now, in arriving at your—did you say in your direct examination that the earnings of the corporation were not sufficient to support the asset values that appear?

A. Yes, sir; definitely not.

Q. So, what did you do with the asset values?

A. Well, we weigh corporations, as I say, from the four points of view, and the earnings factor takes a predominating place. Frankly, I haven't any specific formula to say how much the earnings should weigh, how much assets should weigh, how much marketability should weigh, how much dividends should weigh. [395] They vary in such a number of degrees that we have to consider them all in the light of all the other facts and use our best judgment. That is the human approach to it.

Q. I hand you the stipulation which is in evidence, and on top is joint Exhibit 1-A, and I ask

(Testimony of C. Melvin McCuen.)

you what you think the asset value—what figure you used as to the asset value on ranch real estate?

A. I used the stipulated valuation. That was the value of those ranch real estates to the corporation as of that date.

Q. What figure was that?

A. \$1,629,950.00.

Q. In other words, you say that in making your comparison with other corporations you used the figures in this stipulated fair market value column?

A. I took those into consideration, sir.

Q. Did you take any other figures on this sheet into consideration?

A. Only to accept the \$3,000,000.00 of oil royalties.

Q. Substituting the \$3,000,000.00?

A. Yes.

Q. But those are all the figures on this sheet that you took into consideration in making your comparison with other companies?

A. In comparison with other companies, yes, that would be essentially so. [396]

Q. Now, in making your comparison with other companies, did you consider their asset value?

A. Yes, sir.

Q. What value did you use, the fair market value or the book value?

A. I used their book value, which was away under their earnings value, and, therefore, presumably below their fair market value.

Q. Purely a presumption on your part?

(Testimony of C. Melvin McCuen.)

A. It is a presumption based on many years of study and intense research.

Q. Did you have available to you the fair market value of the assets of the various companies that you considered in making your comparison?

A. No, none of those——

Q. If you had had them, would you have used them in preference to the book values?

A. In order to be fair with my comparisons, I would have had to, sir, definitely.

Q. In other words, the fact that you did not have them available justifies your not using them, but the fact that you did not use them was not exactly a fair comparison, was it?

A. I wouldn't say it is not a fair comparison. Of course, it is very difficult to compare any two corporations even when they look alike and in the same business, but book [397] value of assets and fair market value of assets—oh, I don't know, those are sometimes confusing terms. I do know that the evidence is very strong that the earnings of the Union Oil and the Standard Oil——

Q. Let us stay with assets now, Mr. McCuen. Is it your testimony that it would have been more fair in making your comparison to have used the fair market value of the assets of the other companies in comparison with the fair market value of the assets of the Dominguez, Francis, and Carson Companies?

A. I don't know that it would have been any more fair, but if I had had those fair market valua-

(Testimony of C. Melvin McCuen.)

tions of assets of those corporations, I would have used them although I would not have used the comparison.

Q. At all? A. That is right.

Q. Since you did not have the fair market value figures of the other companies to make the comparison but had their book value figures, and you had the book value figures in our companies, why didn't you use the book value figures in our companies and compare them with the book value figures in the other companies?

A. Well, because it is a well-known fact that the book value figures of the companies that I have used have been very fairly stated. Their earnings will prove the reality of those book values that I think would compare very favorably with the fair market value of those assets if on that date a miracle could have been performed and we had had all the fair market values of those corporations.

Q. Can you state in a few words why you did not make a comparison of like things with like things since you had them before you?

A. It is very difficult in closely held corporations to get comparisons with others. Even two well-integrated oil companies will differ in comparisons. It would be a most coincidental thing if you could find another corporation that in addition to having net working capital, stocks and bonds of another corporation, branch and real estate assets, which would also have oil royalties. But I don't think that that offsets or invalidates the value

(Testimony of C. Melvin McCuen.)

of the comparisons that I have made with these corporations because the Security Company had real estate assets, they had some ranch properties, they had a very excellent list of stocks and bonds, and they had working capital. They did not have any oil royalties. Well, if the assets of that company with known values sold at approximately a 40 per cent discount and were listed on the New York Stock Exchange, I don't think I was very far off in arriving at a value for the Dominguez Estate that was almost equal to 50 per cent of the assets, but that is only coincidental that my \$380.00 coincides with one-half of the assets.

Q. Do not oil royalties have the same relation to an [399] oil property that a bond does to the stock of a corporation?

A. Well, a bond of a corporation is, of course—if it is a contractual obligation, fixed in its terms, it occupies a prior position in the capital structure and earnings of that corporation. Now, an oil royalty has a fixed income if it is earned. It is more in the nature of an income bond, as I would compare it. If it is earned they pay it. If it is not, if the companies do not produce the oil, you do not get it and you cannot foreclose or do anything.

Q. Supposing the Shell Oil Company that is operating some of the leases in this case was operating at a loss, would the Dominguez Estate Company get their royalty?

A. If they kept the production up.

(Testimony of C. Melvin McCuen.)

Q. Supposing they only produced one barrel and they did so at a loss?

A. Well, I would assume that these people would get 1/6th of that barrel.

Q. So that even though the producing company operates at a loss and even though they produced one or a million barrels, the lessor, the Dominguez Estate Company, gets their share of all of the oil produced, don't they? A. Yes.

Q. So, to that extent isn't it very comparable to the bond of a corporation?

A. Well, I don't think I would make that comparison there. [400]

Q. It is a first lien, isn't it, on the property we are speaking about?

A. Well, I don't know. I am not trying not to answer it, but frankly I don't get the value of that comparison. I have an appreciation of oil royalties. You cannot live in California for nearly 30 years without knowing something about them, but how good they are when they are good and how, of course, bad they are when they are not good——

Mr. Melville: Your Honor, may we have a recess for a brief time?

The Court: Very well. We will suspend at this time for a brief recess.

(A short recess.)

The Court: Will there be any further examination of the witness?

(Testimony of C. Melvin McCuen.)

Mr. Melville: Yes, your Honor.

The Court: Very well.

By Mr. Melville:

Q. Mr. McCuen, have you had any experience in dealing in oil royalties?

A. No, I have not.

Q. Have you had any experience in dealing in stocks of oil royalty companies?

A. Well, I have bought or recommended people to buy producing oil corporations who had some royalty interests, yes. [401]

Q. But they were oil companies such as what?

A. The big oil companies here, Superior Oil and Union Oil.

Q. They produced and refined and marketed?

A. Yes.

Q. No companies that just sold——

A. The Superior Oil Company. I have also recommended this one up in Kern County, the Kern County Land Company. I have one account that has 500 shares of that and I keep an active interest in it.

Q. Would you say that that is more comparable to the Dominguez Estate Company than the other oil companies that you mentioned that are producing, refining and marketing?

A. Yes, in that it primarily owns royalty interests, and it has some producing land and some ranch lands.

Q. Do you know any other companies around

(Testimony of C. Melvin McCuen.)

Southern California that are similar to the Kern County in that regard?

A. Yes, here are some others. I think the Southland Royalty and the Louisiana Land and Exploration were very comparable.

Q. Do they have stock outstanding in the hands of the public? A. Yes.

Q. Sold on the local exchanges?

A. No, not on the—well, I think one of them is, and [402] they sold for about six to nine times earnings before depletion. The average of fourteen well-known producing oil companies, as I testified in my testimony here, sold for seven times their earnings in 1941 before depletion.

Q. But those oil companies that you had in mind were the oil companies that are like Standard Oil, aren't they?

A. No, those are Amerad, Barnesdale, Honolulu Oil, Midwest Oil, Mountain Producers and Superior Oil. They are producers only. They have no inventory, refineries, transportation or marketing facilities.

Q. Well, are they comparable?

A. They are more comparable insofar as the oil asset side of the Dominguez Estate is concerned.

Q. Why didn't you use them rather than to talk about banks and investment trusts?

A. I was getting at the asset value. I said that on June 5, 1941, as indicated by the Dow average, that stocks were selling down and assets sold at a discount, and I tried to indicate that if the assets

(Testimony of C. Melvin McCuen.)

of our outstanding leading banks and oil companies sold at about a 50 per cent discount, it was unreasonable to believe that a willing buyer would have paid on an asset basis only—of course, you should consider the earnings and the other factors here—would from an asset valuation only pay more for these assets than he would for those assets. At least, these assets which I have referred to support the values by earnings, whereas the Dominguez Estate Company cannot in my opinion support a \$760.00 valuation on earnings. \$47.00 will not at a fair ratio support such a value.

Q. Would you say from that that the asset value is too high?

A. I would say from that that the prospective buyer and willing seller—

Q. Answer the question. Was the asset value too high? A. It appeared too high.

Q. In other words, you have not approved of the stipulated figures as to the fair market value of those assets?

A. Well, as I understand it, those were the fair market valuations of those assets to the corporation. Now, the fair market valuation of an asset to a corporation is one thing, but when you convert it to stock value per share of common stock to a minority interest, that is an entirely different value from the other.

Q. What could the corporation have sold its stock—talking now about Dominguez Estate Company, Exhibit 1-A—

A. Yes.

(Testimony of C. Melvin McCuen.)

Q. What, in your opinion, could that corporation have converted its stocks and bonds and received cash for, in what amount?

A. Well, I would say approximately as per the stipulated [404] value of \$1,141,270.00. Of course, they hold some shares—they held rather sizeable blocks of stock which, if you had thrown them on the market that day, may have made a difference of a point or two or three points in value. I sold 500 shares of stock on the New York Stock Exchange last week and knocked the price down a point and a half on a very actively traded stock. Of course, from that you would have had a brokerage commission, so I would say on the whole that you would have got substantially in excess of \$1,100,000.00. Probably you would have got—they would have been probably \$40,000.00 off.

Q. All right, let us take the next figure, ranch real estate. How much could that have been converted into cash for, in your opinion?

A. I haven't the slightest idea. I do know at that time that ranch properties sold at a discount. I had the good fortune in 1941, in March of 1941, to purchase 40 acres which I bought for \$4,500.00.

Q. Do you have any views as to what the other real estate could have been converted into cash for?

A. No, I haven't. The sale of real estate properties in 1941—it was a very difficult thing to sell real estate in Los Angeles in 1941 at anything like its fair market value.

Q. You had those facts and situations in mind,

(Testimony of C. Melvin McCuen.)

did you, when you were making your analysis of this case?

A. They were a fractional part of all my knowledge [405] gathered together. That composed part of it, but I would say it was an infinitesimal factor.

Q. Would you distinguish between market price and fair market value?

A. Oh, well, of course, market price on the New York Stock Exchange is synonymous with fair market value in the estimation of many people, but in my definition of fair market value I am in total sympathy with the aims and objectives of the regulation of the Revenue Department. I think you ought to try to arrive at that price which a willing buyer under no compulsion to buy, and a willing seller under no compulsion to sell, each of them having all information of the relative factors involved, what they would have agreed upon. It is hypothetical but I think it is very interesting and perhaps the best way we have to solve these problems.

Q. That is something different, then, is it, from the market price? A. I think so.

Q. What is market price?

A. Market price is what a thing will fetch, whatever the market is, like today the market price of United States Steel is 78.

Q. That is the market price?

A. 78 per share.

Q. All right, what is the fair market price of United States Steel today? [406] A. 78.

(Testimony of C. Melvin McCuen.)

Q. The same? A. Yes.

Q. But you would define them differently?

A. Yes, I think so.

Q. Then define market price for us.

A. Well, in other words, as I say, market price is that price which a security will bring or fetch, it is an actual dealing, whereas fair market value involves considerations of investment values. It is consideration of both sides.

Q. Then, as I understand your testimony, market price is what a thing will bring?

A. Yes.

Q. Fair market price or value is what in your opinion it should bring or in somebody else's opinion it should bring?

A. What it should bring. In other words, it is more subjective and the other is more objective, but the two terms are sometimes used synonymously.

Q. But you do not use them synonymously?

A. Not necessarily. If they are in balance I will use them.

Q. And in this case——

A. What I have tried to do here is to arrive at the fair market value. I am taking into consideration the prevailing price of capital, the price of stocks and bonds all over [407] the country, and how I think those values—what effect it would have had on the value as of that date. The time is a very important element when you value a thing.

Q. In view of your testimony, would it surprise you to know that the parties agreed and stipulated

(Testimony of C. Melvin McCuen.)

that stocks and bonds could have been converted into cash, that that was the fair market value that would have been received for those stocks and bonds on May 31, 1941?

Mr. Mackay: Just a minute, if your Honor please. We stipulated the fair market value of those bonds at that date.

Mr. Melville: The testimony of this witness indicates that he did not understand the stipulation.

Mr. Mackay: I don't think he said that.

Mr. Melville: That is what I am trying to bring out if you will let me.

Mr. Mackay: I won't try to stop you, Mr. Melville.

The Court: You may proceed with your questions.

By Mr. Melville:

Q. Would it surprise you to know that the stipulation means that the ranch real estate could have been converted into cash for \$1,629,950.00 on May 31, 1941?

A. No, I would not be surprised because I think I am informed as to those stipulated values and what the purpose of it was. [408]

Q. Then why did you consider the real estate market and try to make a discount from that?

A. Well, I said, as of that date the real estate market in Los Angeles was depressed.

Q. What does that have to do with our case?

A. It has everything to do when you get down

(Testimony of C. Melvin McCuen.)

to the computation of a minority interest in a corporation which had no power to get those assets, assuming that those were the values to the corporation as of that date.

Q. But if the real estate market had not been depressed, is it not reasonable to assume that the fair market value of this real estate would have been higher?

A. It may have been higher or it may have been lower than that figure.

Q. There are stocks of oil royalty companies being bought and sold on the Los Angeles Stock Exchange, and over-the-counter, in Los Angeles, are there not?

A. I don't think there are any on the Los Angeles Stock Exchange. If there are, I am not familiar with them. The individuals generally get first choice at a good oil royalty. The corporations don't get those.

Q. There either is or there is not?

A. No, I don't think there is on the Los Angeles Stock Exchange, and I don't know of any over-the-counter. They are dealt in by specialists. [409]

Q. How about the San Francisco Stock Exchange, and over-the-counter at San Francisco?

A. I think you will find them over-the-counter.

Q. But you don't know?

A. Oh, yes, you definitely will, but you will probably find more here than you will in San Francisco.

(Testimony of C. Melvin McCuen.)

Q. You will find more over-the-counter sales here than in San Francisco? A. Yes.

Q. Then you will find over-the-counter sales both in San Francisco and in Los Angeles——

A. Yes.

Q. Of stocks of oil royalty companies?

A. Yes, sir.

Q. And they are also traded in on the New York Stock Exchange, aren't they? A. No, sir.

Q. How about the New York Curb?

A. If there are any on that I don't know of them, but I doubt if there are any on there.

Q. But here in California you had available to you at that time the fair market value, or the market price, as you call it, at which stocks of oil royalty companies were being sold?

A. No, I wouldn't say that, not the value, not the fair [410] market value at which they were sold. In other words, you would go up on the third floor and talk to a broker and ask him if he could get you a good royalty. Then after having got it, you would sit down and talk price, but there was no known, posted prices on them.

Q. You said that stocks of oil royalty companies were being traded in over-the-counter in Los Angeles and in San Francisco, didn't you?

A. I was confused. I was thinking—you are thinking of corporations?

Q. Stocks of oil royalty companies, sir.

A. I don't know of oil royalty companies that

(Testimony of C. Melvin McCuen.)

deal exclusively in oil royalties. I don't know of any such.

Q. Well, let us take Kern County.

A. I know, but we would not consider that an oil royalty company. I see what you mean now. That is a corporation and among the assets it has are oil royalties and cattle ranches.

Q. You have covered that.

Mr. Mackay: He has not said "cattle".

By Mr. Melville:

Q. But you have covered the fact that there are stocks, similar stocks to the Dominguez Estate Company, and you mentioned them.

A. That is the only one that is directly comparable. I would say the other three are not directly comparable. [411]

The Court: I would suggest that both the witness and counsel have a little bit of a habit of interrupting the other before the job in hand is completed. I don't say that to be critical.

Mr. Melville: I am sorry. I apologize to both of you.

The Court: You let counsel complete his question before you start to make your answer, and then if he will let you complete your answer before he starts the next question we will have a little better record.

By Mr. Melville:

Q. Then, as I understand it, in your opinion,

(Testimony of C. Melvin McCuen.)

Kern County is the only company that you know of that is really comparable to Dominguez Estate Company?

A. I would say it is the best of comparison that I can think of.

Q. Why didn't you use it in making your comparison?

A. I have it in the comparison here among the oil producing companies.

Q. You listed it right in or considered it right along with the companies——

A. The 14 other companies.

Q. Please don't interrupt me. You considered it right along with the other oil companies which are producing, refining and marketing, is that correct? [412]

A. No; producing companies only.

Q. Did you testify that the earnings of a corporation are one of the most important, if not the most important, factors to be considered in arriving at the fair market value of its stock?

A. Of a going concern, an operating company, that would be one of the most important factors. Of course, it is not altogether the most important factor. Some corporations do not have earnings but yet have assets of considerable value. In such cases you would minimize the earnings factor.

Q. If the Dominguez Estate Company had nothing except its real estate holdings in 1941, how would you have valued that on the earnings basis?

A. Well, I don't think I would have valued it

(Testimony of C. Melvin McCuen.)

on the earnings basis. I would have probably approached it as I did the Security Company. If you take out the oil royalties from the Dominguez Company, you would have a company very comparable to the Security Company, and I valued the Security Company there on the basis of its underlying assets.

Q. So, if you had valued the Dominguez Estate Company with no other assets except its real estate, you would have valued it on the basis of assets?

A. Well, on the estimated liquidating value of its assets if it had no earnings and if it had no working capital and had no stocks and bonds, but just real estate. Of course, I would [413] want enough cash and working capital to see the corporation through, but I would then have estimated the value of the real estate on the present worth basis.

Q. Mr. McCuen, if you knew that Dominguez Estate Company was actually bought and sold around about 1941 for \$1,000.00 a share, would that change your opinion as to the value of that stock?

A. I will answer it this way, that I have approached this——

Q. Just a minute. I believe you can answer that question yes or no, and I wish you would do so, following it with your explanation.

A. No, it would not have made any difference in my valuation here.

Q. You would not change your opinion if you knew there was an actual sale of that stock at \$1,000.00 a share?

A. No, sir, because I brought forth the best of

(Testimony of C. Melvin McCuen.)

my integrity and ability to compute this value, and while I may have been disappointed to find that I was that far off, as I sometimes am disappointed in my calculations of values and how they work out in the future, it would not have changed my opinion one bit.

Q. So that all that this sale or sales at \$1,000.00 a share would do, as far as you are concerned, is to establish that that was the market price? [414]

A. The market price and not the fair market value.

Mr. Melville: No more questions.

Mr. Mackay: That is all.

(Witness excused.)

Mr. Mackay: Call Mr. Eitner.

ADOLPH K. EITNER,

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your name, please?

The Witness: Adolph K. Eitner.

By Mr. Mackay:

Q. Mr. Eitner, you live in Los Angeles?

A. Yes, sir, I do.

Q. What is your occupation?

A. I am an investment banker.

(Testimony of Adolph K. Eitner.)

Q. With whom?

A. Blythe & Company.

Q. Is that the Blythe & Company that is known nationally and internationally?

A. Yes, sir.

Q. How long have you been connected with that company?

A. For twelve and one-half years. [415]

Q. In what capacity?

A. Well, in the past three and one-half years as sales manager in Los Angeles; before that time as statistician, analyst and buyer, working in the buying department.

Q. Prior to that time what was your occupation?

A. It was the same.

Q. For how long prior to that time?

A. From July of 1926.

Q. What has been the nature of your duties since that time, and particularly during the last five or six years?

A. It has been constantly working with securities, appraising security values, both on securities which have established markets and in other instances securities which do not have established markets which we are checking for the purpose of either public or private placement.

Q. You say you are at the present time sales manager for Blythe & Company?

A. In Los Angeles, yes.

Q. And you buy and sell—you have bought and sold a lot of stocks?

(Testimony of Adolph K. Eitner.)

A. Yes, we buy stocks here for the account of the firm, buy them and sell them. I handle a good bit of that.

Q. Now, have you formed an opinion as to the fair market value of this stock of the Dominguez Estate Company as of June 5, 1941? [416]

A. Yes, sir, I have.

Q. Were you supplied with a copy of the stipulation that has been submitted here, together with the exhibits?

A. Yes, sir, I have had those and examined all of them carefully.

Q. And you have made an analysis of those exhibits? A. Yes.

Q. Those exhibits, or some of them, show that all the assets of the Dominguez Estate Company, or each of the assets of the Dominguez Estate Company—withdraw that.

You are familiar with the fact that one of the exhibits shows that the parties have stipulated the fair market value of certain assets of Dominguez Estate Company? A. Yes, sir.

Q. As of that particular date?

A. Yes, sir.

Q. And the only asset not stipulated and which is at issue is the oil royalties of the Dominguez Estate Company? A. Yes, sir.

Q. You are familiar with that?

A. Yes, sir.

Q. In arriving at your value or market value of the stock of the Dominguez Estate Company as

(Testimony of Adolph K. Eitner.)

of that date, what value did you assume or take on the oil royalties?

A. There was another exhibit in connection with the [417] exhibits, and that is the exhibit of expected future royalty income. I don't have it here but I think this is correct from the standpoint of round figures, that the gross projected royalty income to the Dominguez Estate Company was roughly \$9,000,000.00. I discounted that to a present value, using a 6 per cent factor which breaks—

Mr. Melville: Just excuse me one moment, please. Has this witness been qualified to appraise oil royalties?

Mr. Mackay: He is just explaining how he arrived at that. I asked him what value he assumed.

Mr. Melville: He is undertaking to value for the record, as I understand it, oil royalties by starting with the \$9,000,000.00 odd figure and I don't believe the witness has been qualified as an expert to value oil royalties. That is one of the issues in the case.

By Mr. Mackay:

Q. What has been your experience along that line, Mr. Eitner?

A. In connection with oil royalties I have had no experience. We have handled the securities of companies that are mainly producing oil companies, and in one instance an oil royalty company. In another instance we have—in several instances I can recall going into producing companies, and in

(Testimony of Adolph K. Eitner.)

one case a royalty company, in some detail, but no transaction resulted, we could not arrive at a valuation in our own minds [418] which was satisfactory to the prospective seller at the time. So, in proceeding to answer your question, I was not attempting to establish a value of the royalty. I was attempting to establish the value which the royalty represented in the stock, if that is satisfactory.

Q. Yes.

Mr. Melville: Go ahead.

The Witness: I took a 6 per cent factor and brought that down to the present worth, which is roughly \$5,868,000.00. The Dominguez Estate Company paid taxes at a rate of about 15 per cent of their taxable income, which, from a practical standpoint, represented entirely the royalty income. So, deducting taxes from that at the rate of 15 per cent, we get a present worth factor there from the gross figure of \$9,000,000, whatever it was, of \$4,988,600.00, which is the equivalent of \$475.00 a share on the Dominguez Estate stock. That is my valuation on the stock and that is the value which I considered in the royalty. Does that answer you on that point?

By Mr. Mackay:

Q. Yes. Assuming that the fair market value of the oil royalty of the Dominguez Company on the basic date was \$3,000,000.00, as testified to by Paul Paine yesterday, and in the light of this stipu-

(Testimony of Adolph K. Eitner.)

lation and the exhibits, what would be the fair market value?

A. Well, sir, I did not consider the market value of the [419] royalty in the strict sense of that term. The figure that I arrived at—are you asking the figure that I arrived at overall on the Dominguez Estate stock?

Q. Yes, I wish you would give it, please.

A. It is \$407.00 per share.

Q. All right, proceed.

A. In considering this, in approaching this, I, of course, studied and analyzed the earnings statement, the dividend record, the financial statement, and the stipulation of values. The assets broke down into several distinct types. You have, of course, your current assets which are a necessity in any going concern. That is one group. You have your securities, another group. You have your ranch real estate, which had been unprofitable according to the record, in another group. You have another real estate group which had been earning at the rate of about roughly \$50,000.00 a year in the years immediately preceding this valuation date. Then you have those oil royalties which produced the bulk of the income.

I reduced those to a per share basis. The net current assets were \$55.00 per share, and I carried this over to a resultant value of \$55.00. The stocks and bonds on a per share basis are equal to \$109.00 per share. I applied a 30 per cent discount factor to that in arriving at a fair market value, and the re-

(Testimony of Adolph K. Eitner.)

sultant figure is \$76.00 a share. I [420] don't know whether I should go into the discount factors.

Q. I wish you would.

A. Well, I used the general \$30.00 asset values of Lehman Corporation and National Bond and Share, which are both listed investment trusts on the New York Stock Exchange. Lehman Corporation was \$20.75, and the asset value was roughly \$28.75, so there was a 20 per cent discount. National Bond and Share, which is listed on the New York Stock Exchange and has no senior security issue, it has only one class of stock, was around \$15.00 and the asset value was \$21.25. The discount was 29 per cent. On the Security Company the discount was about 38 per cent. Those are the only ones that I have made notes of here before me, but in singling these out, I considered a number of others. I considered those to be about as representative and conservative as you could find in the field, and concluded that applying a 30 per cent discount to the stocks and bonds of Dominguez Estate Company, which did not have the standing or would not have the standing of Lehman Corporation or National Bond and Share, was reasonable.

On the ranch real estate the per share value was \$155.00. I applied a discount factor of 75 per cent to that.

Now, these discount factors I might clarify myself on here to save confusion. They are not a factor that I am applying or questioning on the stipulated value. They are the factor that I am

(Testimony of Adolph K. Eitner.)

applying to the value which I see represented [421] by those assets in the stock itself. I am talking now about the values as they are reflected in the stock itself.

Q. Yes.

A. In arriving at the 75 per cent discount which might appear at first blush to be extreme, we have had—there are comparatively few securities of ranch real estate or general real estate companies that are dealt in freely in the market that are any sort of index. There are a couple out here in California. There is the Marblehead Land Company locally which is not ranch real estate. They have this real estate out in Santa Monica. They had and still have some bonds outstanding and at that time they were selling at around 20 cents on the dollar. I took those because we have had a number of transactions with the company and know the management and had a good idea at that time as to how they considered the future would work out so far as those bonds were concerned. The Sutter Basin Company, I think the work-out has been better than they anticipated. The Sutter Basin Company owned some farm lands up here in Northern California and they had some bonds outstanding which traded with the stock, and they were trading at around 35 cents on the dollar. Now, both the Sutter Basin Company and the Marblehead Land Company were definitely liquidating propositions, liquidating real estate propositions. They were actively selling the real estate, and with the proceeds from

(Testimony of Adolph K. Eitner.)

the sale of the real estate they would [422] go into the market and buy their own securities, and they had already bought very substantial amounts of their own securities, and to that extent the market value for their securities would be influenced to be high rather than to be low.

There is a company locally that might be thrown in as a comparison, and that is this Los Angeles Investment Company. They had some stock out at the time, and still do, in fact. That was selling at around $77\frac{7}{8}$. The liquidating value of the Los Angeles Investment at that time in the opinion of the management was around 18 to 19 a share, so, that figured a value of 43 cents on that day. However, in the sales of the other two there was a distinct liquidating program which sets a favorable and high market for the stock. Without that buying interest in the market there is every reason to assume that all three of those securiteis would have been selling much lower. Well, that covers the 75 per cent discount. You have your per share of \$155.00 as reduced to \$39.00 as represented in the stock.

Other real estate of \$1,631,000.00 is roughly \$156.00 a share. I applied a 50 per cent discount factor to that and arrived at a fair market value in the stock as represented by the stock of \$78.00 a share.

Now, in appraising that, I took into consideration that that represented building properties which were producing [423] some earnings, roughly

(Testimony of Adolph K. Eitner.)

\$50,000.00 a year. That \$50,000.00 a year reduced to a figure on my valuation is about 6.4 per cent return on the investment which would indicate a comparatively high value in comparison with other prices that were in the market at that time. [424]

You had the Taft Building 6 per cent bonds outstanding which were around 66 to 69, so that at the 6 per cent rate the return there would be around $8\frac{1}{2}$ or better per cent.

Russ Building 6's, 1951, would be selling around 90. That is in San Francisco and it is a first-class office building with a good record, and the returns there would be roughly 7 or $6\frac{1}{2}$ per cent, figuring the yield to maturity.

Subway Terminal Building bonds, in Los Angeles, paying 4 per cent interest and just earning it, were selling around 30.

Central Hollywood, or Equitable Building, bonds, which were paying interest at about 5 per cent and showing earnings about double that amount, were selling at about 75 to 80, with the stock.

So, that covers the 50 per cent discount there.

Now, on your oil properties, from the figure of \$475.00 a share I took a discount factor of 45 per cent, which produces a figure of \$261.00. Now, the reason I took the discount factor of 45 per cent is mainly in comparison with the common stock of the Dominguez Oil Field Company. The major assets of the Dominguez Oil Field Company were certain leases which were covered by some of the

(Testimony of Adolph K. Eitner.)

royalties. We were members of an underwriting group which, I think in November of 1938, had acquired and offered publicly a [425] substantial block of Dominguez Oil Field Company stock in the market. We paid 32½ a share for it and offered it for 36. The price on June 5, 1941, was \$30 a share. The stock had paid \$3 in dividends. In fact, in 1939 I think it paid a little extra, and in 1938 there was, I believe, a fairly substantial extra dividend paid.

At the time we bought the stock we proceeded on the basis that we would have to get a report from a responsible geologist and oil engineer and we asked Mr. Payne if he would make an examination of the properties and project figures as to what one could expect in the way of earnings. He did that and came up with a tabulation which is rather similar to the exhibit. Then he eliminated from that the projected expenses and projected taxes, discounted it at a 6 per cent present worth factor, and came up with assets there of \$65.00 a share. We paid \$32.50 for the stock, or 50 per cent for it. In 1941, with the stock at 30, after it had been out for two years, it was selling at a figure which was less than 50 per cent, and that is how I accomplished this 45 per cent discount factor.

The Court: We will suspend for a brief recess.

(Short recess.)

A. (Continued) I think we had—can I just pick it up?

(Testimony of Adolph K. Eitner.)

By Mr. Mackay:

Q. Yes, please.

A. I think we had come down to the 45 per cent discount factor on the oil properties, arriving at a resultant value of \$261.00 a share. Adding all these figures together you get a figure of \$509.00. Now, that, I believe, would have been the value of the stock had it been a stock which had a ready and active market in the common sense of the term, and general information on it would have been generally available, and all that sort of thing. Without that, in other words, because of the absence of the market, because of the fact that it is a personal holding company, because of the fact that we are talking about a minority interest, and that sort of thing, I am applying a 20 per cent discount to the total here, which amounts to \$102.00, bringing the figure out at \$407.00 a share. This price of \$407.00 is a capitalization of the 1940 earnings at 11.6 per cent. It is a capitalization of the 1939 earnings at 13.9 per cent. It is a capitalization of the \$72.00 dividend, which was earned to the extent of \$24.70, at 17.7 per cent.

That, I think, covers it as far as the Dominguez Estate is concerned.

Q. So, then, your opinion of the fair market value of the Dominguez Estate Company stock on that date was what? A. \$407.00.

Q. Did you determine an opinion of the fair

(Testimony of Adolph K. Eitner.)

market [427] value of the Francis Land Company stock on that date?

A. Yes, sir, I have.

Q. Will you please tell how you arrived at that?

A. From a practical standpoint the only asset of Francis Land is the 5,499 shares of Dominguez Estate. That is 1.0908 shares of Dominguez Land for each share of Francis Land, or 1.1 for practical purposes. This produces \$447.70 a share on Francis Land. The true assets in this company are in Dominguez, not in Francis, and the Francis Land stock is one step removed through its ownership of Dominguez stock. Therefore, I do not believe you can take the full figure of \$447.70 per share of Francis Land, but that you must discount it, and I am discounting it by 5 per cent, which is possibly too low a discount, and that produces a figure of \$425.50, which in my opinion is the fair market value on that date.

Mr. Melville: What was that again?

The Witness: \$425.50.

By Mr. Mackay:

Q. And did you also arrive at the fair market value of the Carson Estate Company stock?

A. Yes, sir. I have arrived at a value of \$230.00 a share on Carson Estate Company stock.

Q. Will you please tell the court how you arrived at that? [428]

A. The Carson Estate Company is a sort of small Dominguez Estate, in a way. You have the

(Testimony of Adolph K. Eitner.)

current assets, you have the ranch real estate, and you have the other real estate, which in the case of Carson is non-productive. You have a very small royalty interest, and then you have the Dominguez stock and Francis Land Company stock which is owned by Carson. Now, in order to simplify the procedure, I have reduced that straight back to Dominguez, and in this case that establishes that there are .4475 shares of Dominguez in each share of Carson. Now, following through the same line of reasoning that we have on the Dominguez Estate, taking your next parent assets, which amount to \$22.00 a share, at \$22.00; taking your ranch real estate, which is at \$60.00, at a 75 per cent discount, which results in a figure of \$15.00 a share; your other real estate, which amounts to \$20.00 a share, and applying a 75 per cent discount—it is non-productive entirely—brings you to a figure of \$5.00 a share. The oil properties on the same present value basis as we applied in Dominguez but without any tax deduction—and the reason that I did not take any tax deduction was that Carson was apparently in a position to minimize his tax expense—we bring a gross figure of \$356,500.00, which is \$48.00 per share. Discounting that by 45 per cent, we get a figure of \$27.00 a share. Then we have the Dominguez stock, .4475 shares at the undiscounted figure of \$509.00 a share— [429] we don't want to pyramid discounts—we have a personal holding company and a no-market situation here and all that, less the 5 per cent because of the

(Testimony of Adolph K. Eitner.)

removal from the original source, amounts to a figure of \$217.00. Totalling that at \$286.00 and applying a 20 per cent discount accomplishes a figure of \$230.00 per share. The 20 per cent discount is for the personal holding and the absence of a market, the small minority position, and factors of that sort.

Mr. Mackay: You may take the witness.

Mr. Melville: May I suggest, your Honor, that it is a quarter of 5:00?

The Court: I think we will proceed.

Cross Examination

By Mr. Melville:

Q. How much of a discount factor—going back now to Dominguez—how much of a discount factor did you apply to current assets? A. None.

Q. Your discount factor with respect to stocks and bonds was 30 per cent, I believe?

A. Correct.

Q. I don't understand fully just why you used 30 per cent. You are in the brokerage business?

A. No, I am in the investment business. We buy and [430] sell for our own account; we underwrite rather than act as brokers.

Q. Of all of the assets that are included within the frame work of Dominguez Estate Company, your business is most familiar with the stocks and bonds, more so than with real estate or——

A. That is correct.

(Testimony of Adolph K. Eitner.)

Q. ———or oil royalties?

A. That is correct.

Q. So, tell us, if you will, just why you arrived at 30 per cent.

A. Investment trusts which do not have a so-called syndicate market, which is an entirely supported market, consistently have sold at discounts for the past 15 years from the asset value of the securities themselves. By "asset value" I mean the aggregate market value divided by the number of shares.

In the case of the two most representative, which are listed and traded on the New York stock exchange and can be assumed to have probably the broadest market, and which do not have a leverage factor in that they do not have senior securities out, in other words, they are comparable to Dominguez which does not have senior securities out—the one that was available on June 5th at a price equal to a discount of 27 per cent from the asset value, the National [431] Bond & Share, was at a discount of 29 per cent.

Now, I cannot visualize a willing buyer that is informed of all the facts who will pay a price for what is represented by the investment account of the Dominguez Estate Company that is more than he would pay for the equivalent in Lehman Corporation or National Bond & Share, and for that reason I have applied the 30 per cent discount to it.

Q. That is Lehman Brothers?

(Testimony of Adolph K. Fitner.)

A. And National Bond & Share. National Bond & Share is a trust that has been more or less sponsored by Domenick & Domenick.

Q. And both these securities outstanding, I mean, stocks of their companies are publicly owned?

A. Yes, and traded on the New York Stock Exchange.

Q. Now, supposing that the stocks and bonds in the Dominguez Estate Company consisted entirely of stocks of Lehman Brothers and National Bond & Share, would you still discount them 30 per cent?

A. Yes, sir, I would.

Q. Why? You have already taken a 27 and a 29 per cent discount from the——

A. You have no assurance that they are going to be retained in Lehman Brothers or National Bond & Share. The management might see fit to sell, and that is all you can realize for them and that is the figure that you take into account in the asset value of an investment trust. [432]

Q. You say the figure you can realize?

A. The asset value, the figure that we are talking about, is the aggregate market value represented by the investment of these trusts divided by the number of shares. Now, whether that be government bonds, whether that be other investment trusts, whatever that be, there is no assurance that it is going to continue in that position. This is all hypothetical, anyhow, that is, your question is. I believe that the same factors should be applied under the circumstances.

(Testimony of Adolph K. Eitner.)

Q. All right. Then the stock of Dominguez is owned by Francis, and why would not another 30 per cent apply?

A. Francis, apparently—I don't know, frankly, the reason that Francis Land Company—I believe that I have been very liberal in applying a 5 per cent discount factor.

Q. But that does not answer the question. Going back now, if Dominguez Estate Company owned—going all the way back, Lehman Brothers owned certain securities? A. Yes.

Q. The sales price or fair market price of Lehman Brothers stock about our basic date reflected a discount of 27 per cent over the fair market value of the stocks which it held, is that correct? A. That is correct.

Q. And the same thing is true now with National Bond & Share except the discount was 29 per cent?

A. That is correct.

Q. Now, you say that if the Dominguez Estate Company had \$1,141,269.74 invested in the stocks, exclusively the stocks of Lehman Brothers and National Bond & Share, you would still take a further discount factor of 30 per cent?

A. That is correct.

Q. Now, one step further.

Francis Land has all of its money, that is, its stocks and bonds, in the stock of Dominguez Estate Company? A. That is correct.

Q. Just why wouldn't you take another 30 per cent?

(Testimony of Adolph K. Eitner.)

A. Dominguez Estate Company does not have a ready and active market. You cannot establish the asset value in the sense of the term that we are applying it in this case. I am going back to the original asset in this case. Now, you have one example that is somewhat comparable, and that is where you have a holding company or an investment trust, or call it what you will, which holds, from a practical standpoint, only one stock or security, and that is this Christiana Corporation, which owns a substantial amount of DuPont, and a nominal amount of General Motors. That stock on June 5th had an asset value of about \$2,500.00 a share—excuse me—\$2,900.00 a share. The market value on it at that date was around \$2,400.00. So, you have a discount there and you have the similarity of the one asset. [434]

Q. Did you consider that at that time with respect to Christiana when you——

A. Yes.

Q. Did you study Christiana Securities carefully? A. Yes.

Q. Do you know when those securities were purchased by Christiana?

A. Many, many years ago, I think.

Q. If Christiana sold its assets and liquidated as of June 5, 1941, it would have had tremendous capital gain taxes to pay, wouldn't it?

A. I frankly don't know. It is an assumption that they will not liquidate and sell and that you are going to have a continuing interest in the

(Testimony of Adolph K. Eitner.)

General Motors and in DuPont which prompts the buyer to purchase the stock.

Q. Do you know the cost of a share of Christiana when it was originally issued?

A. No, I don't.

Q. You did not go back of the 1940 or 1941 period?

A. No. On Christiana? No, I have not.

Q. You did not make a very careful study of it, then, did you?

A. Well, I made a study to this extent, that we know the make-up, I mean, we know the make-up of the assets of Christiana, the fact that they serve as a market for DuPont, and the preferred stock that is outstanding, and we arrive at this calculation. Now, there is no proper reason to assume that liquidation and the assumption of tax liabilities are in prospect. It is simply a medium for buying DuPont a little bit cheaper to the investor, and the only reason he would buy it is because he can buy his DuPont a little cheaper that way.

Q. Is it not a fact that Christiana Securities were selling in 1941 at our basic date at more than the liquidated asset value, the fair market value of the assets less taxes?

A. Now you are not talking about the aggregate sale price. You are talking about the deduction of taxes, and so forth.

Q. Let us assume the Christiana Securities liquidated in 1941.

(Testimony of Adolph K. Eitner.)

A. I don't know what the tax liability would have been.

Q. You cannot answer the question, then?

A. Correct.

Q. You spoke in direct examination about the absence of a market for Dominguez Estate Company stock? A. Correct.

Q. And you took a discount factor for that, I believe? A. Correct.

Q. Would it surprise you to know that there was a ready market for Dominguez Estate Company stock? [436]

A. It would surprise me, yes.

Q. And would you change your testimony if that is established as a fact in this case?

A. In other words—may I rephrase your question to see if I understand it clearly?

Q. Yes.

A. In other words, let me assume that if I have some Dominguez Estate Company stock I can be assured of selling it at a certain figure, or I can just be assured of selling it?

Q. Selling it at a fair figure.

A. Under duress?

Q. No.

A. Or pressure? No, because I believe the figure would be approximately the figure that is arrived at here, within reach of that.

Q. Do you know of any sales of the stock of the Dominguez Estate Company at any time?

A. No, sir, I do not.

(Testimony of Adolph K. Eitner.)

Q. If there was a sale of the stock of the Dominguez Estate Company in—well, let us say, June, 1941——

A. June 5th.

Q. —June 5th, 1941, at \$1,000.00 a share between a willing buyer and a willing seller, would that be in your opinion the fair market value of that stock? [437]

A. I would want to be familiar with the circumstances of sale. I would like to know who the buyer was and who the seller was.

Q. The buyers is a willing buyer, well informed, and the seller is a willing seller, well informed, neither being under any compulsion or duress to buy or sell; would that in your opinion establish——

A. How many shares?

Q. Let us say 100 shares. Let me ask you this, isn't 100 shares the usual unit in buying and selling stocks and bonds?

A. No, not necessarily.

Q. Well, if you buy less than 100 shares you pay a premium, don't you?

A. Not necessarily. There are lots of 10-share markets and 5-share markets.

Q. All right, we will talk about 100 or 200 shares.

A. I don't believe that a single transaction—I think it would influence my ideas some, but I do not believe, however, that a single transaction on a single date between a willing buyer and a willing sellest establishes a fair market price. If there were a series of transactions, then you are talking about something.

No. 11506

United States
Circuit Court of Appeals
For the Ninth Circuit.

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

In Three Volumes

VOLUME II

Pages 397 to 785

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of the United States

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(Testimony of Adolph K. Eitner.)

Q. What does it establish?

A. It establishes a transaction price at which the [438] stock traded.

Q. So you subscribe to Mr. McCune's views that the fair market value and the fair market price are two different things?

A. Well, no, I think we have to go a little further than that. I believe, for example, that a series of transactions in any security on the stock exchange represents fair market value, and the price is synonymous there.

Q. I don't believe that answers my question.

A. Well, it does not. Let us hear the question again.

Mr. Melville: Read it.

(Question read.)

The Witness: Let us go back to your original question and the \$1,000.00 a share on June 5, 1941.

By Mr. Melville:

Q. Could I have an answer to the last one first?

A. No, I would rather hear the—I will say, no, I do not subscribe to his views that there is a difference between price and value, assuming that your transaction which sets the price has all the circumstances that you outlined.

Q. What is your definition of market price?

A. You can have a market price——

Q. Can't you define market price? You use it.

A. If you will bear with me a minute here, you

(Testimony of Adolph K. Eitner.)

can have a market price which is not a fair market value. In [439] other words, you can have duress which establishes a price. Now, if you have all the factors in the transaction which——

Q. You may have misunderstood my question. I did not ask you to differentiate between fair market value and market price. I simply asked you to define market price.

A. Market price is the price at which the transaction takes place.

Q. All right. What, then, is your definition of fair market value?

A. My definition of fair market value would be the price at which a transaction, a purchase and sale, can be made between a willing and informed buyer and a willing informed seller without compulsion on either side.

Q. So your definition of the two are different by they boil down to the same thing, don't they?

A. No, because your transaction does not necessarily always involve a willing buyer and seller. You have transactions that result from duress or pressure.

Q. All right, let us talk about the transactions over the New York Stock Exchange today. Do they establish the fair market value of the stocks traded in?

A. I think they do, yes.

Q. Do they establish the market price of those stocks?

A. Yes, they do.

Q. Then is it your testimony that in all cases where there is not duress or a forced sale or some

(Testimony of Adolph K. Eltner.)

very unusual [440] extenuating circumstance, fair market value and market price are the same thing?

A. Yes, I would say that is the case, excluding extenuating circumstances.

Q. All right. If in 1941, and we will assume on June 5, 1941, a willing buyer under no compulsion to buy and not being under any pressure of any kind and a willing seller that owned some of this stock bought and sold at \$1,000.00 a share and the amount of the transaction was 100 shares or 200 shares, what would that establish, the fair market value or the market price, in your opinion?

A. I think a hypothetical case like that would probably establish the fair market value.

Q. Fair market value?

A. Yes, on a hypothetical basis.

Q. A hypothetical case? Now, if before this trial is over the government should introduce testimony that there were actual sales of this stock in 1941 at \$1,000.00 a share, would that establish a fair market value at \$1,000.00 a share?

A. I would have to know the circumstance of the sale.

Q. No compulsion to sell, a willing buyer, and a willing seller, the same circumstances as those we have gone over.

A. Well, I must still say I would have to have more detail as to what the circumstances surrounding the [441] transaction were before I could answer.

Q. If a hypothetical situation that we went over a few moments ago——

A. Yes.

(Testimony of Adolph K. Eitner.)

Q. —brought you to the frame of mind where you would feel that that hypothetical situation would establish the fair market price, why wouldn't the actual situation establish it?

A. Well, I suppose the answer is, yes, that it would establish it, but I still say that I would—before I would answer it for myself I would want to see some of the circumstances about it.

The Court: We will suspend at this time until 10:30 tomorrow morning.

(Whereupon, at 5:05 p.m., a recess was taken until 10:30 a.m., Thursday, October 11, 1945.)

PROCEEDINGS

October 11, 1945, 10:50 a.m.

The Clerk: Docket No. 2257, Victoria L. Cotton, and 7583, Virginia Caldwell.

ADOLPH K. EITNER,
resumed his testimony as follows:

Cross Examination (resumed)

By Mr. Melville:

Q. Mr. Eitner, as I understand, yesterday you testified that the stipulated royalty income of roughly \$9,000,000.00 plus was valued at 6 per cent compound interest discount to give \$5,868,000.00, is that correct?

A. That is correct, yes sir. I assume your figures are correct. (After examining) That is correct.

(Testimony of Adolph K. Eitner.)

Q. Then you deducted, I believe, 15 per cent for taxes? A. Yes, sir.

Q. And that amounted to \$880,200.00?

A. 300 I have here in my notes.

Q. The balance of the fair market value of the royalties, then, as an asset to the company, amounted to how much?

A. I did not testify that I considered that the fair market value of the royalty. The residual figure was \$4,988,000, roughly \$5,000,000.00.

Q. The value per share of the trust, then, was \$475.00? A. Yes, sir.

Q. That value of \$4,988,000.00, approximately, and all [447] stipulated fair market values of assets were then discounted further, each at an individual rate, to obtain the values of the share of each asset to the stockholder? A. Yes, sir.

Q. The total net asset value, then, to the company was \$950.00 before any discounts to determine the value of the same corporate assets to a stockholder? A. That is correct.

Q. That is what it would cost the company, then, to replace the assets in kind?

A. I don't believe I can testify as to what it would cost the company to replace the assets in kind.

Q. You have just testified that that is the fair market value of the assets. If something has a fair market value, why couldn't it be replaced in kind at that figure?

(Testimony of Adolph K. Eitner.)

A. I did not testify as to the fair market value of the royalty.

Q. All right. The asset value of the royalty added into the balance sheet is \$475.00 per share, isn't it?

A. Maybe we could define that figure of \$475.00 in the manner in which it was computed, which is taking the——

Q. Is it or is it not \$475.00?

A. \$475.00 is correct.

Q. All right.

Mr. Mackay: He has a right to explain his answer. [448]

Mr. Melville: I think it will be explained, Mr. Mackay, If I am permitted to proceed with my questions.

The Court: Proceed.

By Mr. Melville:

Q. Do you agree, then, that the total net asset value to the Dominguez Estate Company was \$950.00 before any discounts to determine the value of the same group of assets to the stockholders?

A. Yes, those are the asset values that I have computed.

Q. And that is based upon the stipulated fair market values of everything except oil royalties?

A. Correct.

Q. Would you say, then, that the figure of

(Testimony of Adolph K. Eitner.)

\$950.00 represents what it would cost the company to replace those assets in kind?

A. No, sir, I would not.

Q. Would you explain?

A. I have no way of knowing or having an opinion as to what it would cost them to replace the oil royalties. I would agree on the other items that your statement is correct.

Q. Could they replace an oil royalty such as they have here with one just like it at any price?

A. I could not speak on that subject.

Q. Then does the figure of \$950.00 represent the value of the only asset you know about through the stipulation and [449] through your knowledge?

A. I am sorry. I didn't get the—does that represent the fair market value—

Q. No, the value.

A. By value, I assume fair market value.

Q. Go ahead. You assume it.

A. I think I should answer the question—in answering the question, I will agree on everything but the oil royalty. The oil royalty is a reduction at present values of the expected future income based on the projection which is entered as an exhibit.

Q. Now, as I understand it, Mr. Eitner, in dealing with ranch real estate you took the figure which was stipulated as the fair market value of the ranch real estate and applied a discount of 75 per cent?

A. In appraising the value which it represents in the stock.

(Testimony of Adolph K. Eitner.)

Q. That is right. A. Yes, sir.

Q. But you do not dispute the fact that the fair market value of the royalty was as stipulated?

A. Not in the least.

Q. Although you do apply a discount factor of 75 per cent?

A. In bringing it through to the stock, that is correct. [450]

Q. Now, on oil royalties you apply, instead of a 75 per cent factor as you did in real estate, a 45 per cent factor? A. That is correct.

Q. And arrive at a figure of \$261.00?

A. Yes, sir.

Q. Why, then, aren't you willing to let us fill in the figure of \$475.00 in the asset column following your other figures of \$55.00 for net current assets, \$109.00 for stocks and bonds, \$155.00 for ranch real estate, and \$156.00 for other real estate? If we do the same thing now as to oil royalties, carrying back your \$261.00 figure with a 45 per cent factor, we would arrive at a figure of \$475.00? Isn't that a fair presentation of your testimony yesterday?

A. It is a fair presentation with this qualification, I believe, that you must explain the \$475.00 figure as to how it is arrived at, and should not confuse it with the thought that I have any knowledge of what the market value of that royalty was as of the basic date, because I have no such knowledge.

Q. Did you use as a basis for your testimony yesterday the figure of \$475.00 as being the asset value

(Testimony of Adolph K. Eitner.)

back of the Dominguez Estate Company stock as represented by the oil royalties?

A. Yes, as a capitalization of the expected income.

Q. The same as you used \$156.00 for other real estate? [451]

A. No, that represents the fair market value of other real estate, and I do not say that the \$475.00 figure represents the fair market value of the royalty.

Q. Reconstructing your testimony with respect to Carson Estate Company stock; I believe the stipulation shows, and you took it into consideration in your testimony, that the Carson Estate Company owns directly 1,785 shares of Francis Land Company stock? A. Yes, sir.

Q. And in view of the fact that each share of Francis Land Company stock has back of it approximately 1.1 shares of Dominguez Estate Company stock, then isn't it true that the Carson Estate Company owns through its Francis stock the equivalent of 1,963 shares of Dominguez stock?

A. Yes. I have not computed—I haven't my figures on that here, but I assume that is correct.

Q. In order that you might follow my line of questioning, I would be glad to give you a copy of the way we have tried to reconstruct your testimony (handing). A. Thank you.

Mr. Melville: It is not in evidence, your Honor.
By Mr. Melville:

Q. If you would like to make that computation

(Testimony of Adolph K. Eitner.)

of 1.1, approximately, times 1,785, I think you will arrive at 1,963.

A. That is correct, yes. [452]

Q. Now, then, the number of Dominguez shares directly owned were 1,353? A. Yes, sir.

Q. Therefore, the number of shares of Dominguez directly or indirectly owned would be 3,316?

A. Yes, sir.

Q. The shares of Carson outstanding were 7,412?

A. Correct.

Q. The shares of Dominguez in relation to shares of Carson gives us a factor of .4475?

A. Correct.

Q. Now, you had a value of \$509.00 for Dominguez stock as carried into Carson, didn't you?

A. Yes, sir.

Q. Now, apply the factor of .4475; you get \$228.00 to the Carson Estate Company, wouldn't you?

A. That is correct.

Q. Then you take a 5 per cent discount and get \$217.00? A. Correct.

Q. Now, would you go on from there and explain the rest of this schedule and fill in any blanks that might appear?

A. Could I borrow a pencil for a moment?

Q. Yes, sir.

A. I left mine at the office, unfortunately.

(A pencil was handed to the witness.) [453]

A. (Continuing) (After making computation). Oil properties brought down to a present worth basis

(Testimony of Adolph K. Eitner.)

in the same manner as in the case of Dominguez brings them down to \$356,501.00, which is \$48.00 a share. We applied the same discount factor to get a total as represented in the value of the stock of \$27.00 a share. Net current assets were a total of \$167,778.00, which brings you out at \$22.00 a share and we carry that over at \$22.00 a share. Ranch real estate at \$446,000.00, or \$60.00 a share, carries over with the 75 per cent discount to \$15.00 a share. Other real estate, \$147,000.00, with a 75 per cent discount in this case, gives a gross figure of \$20.00, and a net figure of \$5.00. You have a 50 per cent in here, Mr. Melville.

Q. Yes. Is that wrong?

A. That should be 75 per cent. That brings you out to \$5.00 a share.

Q. Just at that point, let me ask you, Mr. Eitner, yesterday when you discounted in the case of Dominguez Company the ranch real estate at 75 per cent, it was my understanding of your testimony that you discounted other real estate at 50 per cent.

A. I did in the case of Dominguez.

Q. Will you explain why you did not do that in Carson?

A. I did not do that in Carson because the Carson real estate for 1939 and 1940 and in the immediately preceding [454] years had been non-productive so far as net income was concerned. It was not producing any earnings.

Q. Go on.

A. That bring you out to \$5.00 a share. Your

(Testimony of Adolph K. Eitner.)

stocks and bonds are blank, I believe, in the case of Carson. Is that correct?

Q. Yes, I believe so.

A. So that is eliminated. We run a total here of \$286.00, which we discount by 20 per cent, which is \$56.00, arriving at the final figure of \$230.00.

Mr. Melville: No more questions.

Mr. Mackay: That is all. Thank you.

(Witness excused.)

Mr. Mackay: If your Honor please, Petitioner at this time has no more witnesses. There is one thing I would like to clear up, though, and we have not quite got it ready. In one of our exhibits we show the stockholders of each one of the companies and their names, and what I should like to do is to get a list showing the relationship of the Petitioner to these other stockholders. I am not prepared to do that right now.

Mr. Melville: No objection.

Mr. Mackay: We will get that and put it in later.

The Court: Are you ready to proceed with the testimony for the Government? [455]

Mr. Melville: I did not understand that the Petitioner had rested.

Mr. Mackay: Yes.

The Court: I understand he is resting with the understanding that he wants to put in one additional stipulation or Petitioner's exhibit. Is that correct, Mr. Mackay?

Mr. Mackay: Yes, your Honor.

The Court: You may proceed.

Mr. Melville: Call Roger White.

EVIDENCE ON BEHALF OF RESPONDENTS

Thereupon, the Respondent, to maintain the averments on his own behalf, introduced the following proof:

ROGER F. WHITE,

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your name, please, sir.

The Witness: Roger F. White.

By Mr. Melville:

Q. Mr. White, what does your formal education consist of?

A. I graduated from high school in the State of Colorado and received the degree of Engineer of Mines at the Colorado [456] School of Mines in 1918.

Q. At the Colorado School of Mines did you take various courses in mathematics?

A. Yes, sir.

Q. What courses?

A. Well, practically all of them up through calculus, trigonometry, analytical geometry, and so forth, up through calculus.

Q. Do you know how to operate a calculating machine?

A. Yes, sir.

(Testimony of Roger F. White.)

Q. Have you confidence in the results?

A. Yes, sir.

Q. Were you present during the testimony of Mr. Paine? A. Yes.

Q. You listened to the various yardsticks that he used in reaching his valuations? A. Yes.

Q. Were you present in court when the government and the Petitioner reached a stipulation as to the fair market value of the oil royalties in the Carson Estate Company? A. Yes.

Q. And do you recall what that figure was?

A. Yes.

Q. What was it? A. \$285,000.00. [457]

Q. Now, by reason of your mathematical training, can you convert that \$285,000.00 back into the yardsticks and then apply those yardsticks to the matter which is still in question in the Dominguez Estate Company case? A. Yes.

Q. Have you done so? A. Yes, sir.

Q. Would you please explain to the Court the results of your calculations?

Mr. Mackay: If your Honor please, I object to that as being entirely irrelevant, immaterial, and incompetent. This Court has the record here, and from the evidence the Court is the one to pass upon the weight of the testimony. The Court is the one who makes its conclusions from all the evidence. It seems to me to be entirely incompetent for this witness here, who has run an adding machine and who relies upon the adding machine as being correct—which I might say that I do if you get the

(Testimony of Roger F. White.)

right figures—but that does not make him an expert on valuation. If your Honor please, there are a lot of things to weigh in this particular case. The witnesses have time and time again testified as to the particular factors going into each particular lease, each particular property, and a lot of those other things. Now, what counsel is trying to do is to superimpose upon your Honor a mathematical computation to try to prove a value. So, if your Honor please, I may [458] say this, that those mathematical computations can be made as well in the brief as before your Honor. I know one thing, they are not proper before a court, and I object to them.

Mr. Melville: Your Honor, we are not trying to impose on the Court any opinion of this witness as to the fair market value of oil royalties in the Dominguez Estate Company case. We are simply trying to assist the Court by doing for the Court the mathematical computations which the Court might want to do himself. If the Court, after hearing the computations, thinks they are of no weight or importance, the Court has the discretion, of course, to disregard them. I have not asked the witness for an opinion. I have simply asked him to do a mathematical computation which I as a lawyer do not know how to do.

Mr. Mackay: If your Honor please, if permitted, I would like to and would probably have to follow up with a very good accountant who has computed the values, taking into consideration the actual taxes, and we could spend several weeks here

(Testimony of Roger F. White.)

showing that the same computations my friend is making would be no values. I think it has no place, if your Honor please, in a proceeding before this Court to do that.

Mr. Melville: Your Honor, while Mr. Paine was on the witness stand there was a little conversation back and forth among us in a very jovial mood, during which the witness, Mr. Paine, made some disparaging remarks about our profession, [459] and the Judge remarked that he would be very happy if the engineers would give him a yardstick which was fairly accurate. Now, we have in this case two oil properties to value at exactly the same date, June 5, 1941. Both parties have agreed upon the fair market value of one oil royalty as of that date. It seems to me that your Honor might well consider how that, worked back through a yardstick, would bring out the answer to the one remaining question as to the underlying assets in the Dominguez Estate Company case. I think it is entirely proper for the Government to furnish this Court with such a calculation.

Mr. Mackay: If your Honor please, I would like to be heard on that. It seems to me it is absurd. Your Honor will recall the testimony with respect to the various leases, and the oil royalties in the Carson Company were very minor, conditions were different, and the witnesses have so testified. Now, if your Honor please, we have not got all the evidence in here. I propose, and I think I have that right, and I propose, depending upon what counsel

(Testimony of Roger F. White.)

put in the record, to put on evidence in rebuttal. Are we going to stop every 15 minutes when a witness gets off the stand and say, "We have got a yardstick and that will settle the case"? That is where we are going if you let this witness testify along that line. I submit, if your Honor please, that it is entirely improper. The evidence is not in yet. We would have a right to make our [460] computations. We have accountants and we have engineers, and I may say they can run comptometers and adding machines as well as Mr. White. I don't think it is a proper thing, and if he goes on with that we want to analyze what is going on. Until the evidence is in and the Court can see all the evidence, I think it is improper. We can submit any computations we want to in the brief.

The Court: I am not sure I understand exactly what sort of a computation you are proposing to offer, Mr. Melville. You have agreed here upon the value of certain oil properties owned by the Carson Estate as being \$285,000.00.

Mr. Melville: That is right, your Honor.

The Court: Now, from there where is it you propose to go and what is it you propose to do by this mathematical calculation?

Mr. Melville: Simply this, your Honor, that we have two things where there are oil royalties or barrels of water or tanks of turpentine, or anything else, and we want to know how much is in this tank and we have no yardstick, but we do know how much there is in this other tank. We can

(Testimony of Roger F. White.)

take a long pole or a stick and put it down in there and see how far up the water or the turpentine comes, and then if we put it down in the other tank and find out it only comes half-way up, doesn't it follow, your Honor, that there is only half as much turpentine in the one tank as there is in the other, and yet we did [461] not have a yardstick to do it with.

The Court: Well, I understood that these oil royalties in the Carson Estate were recognized as being comparatively insignificant, and that you were not going to take any time to prove the value of them.

Mr. Mackay: That is the only purpose for which we did it, your Honor.

The Court: The purpose of your admission——

Mr. Mackay: That is the only purpose and it was for no other purpose.

Mr. Melville: Your Honor, the witnesses that have been on the stand so far, and they have all been petitioner's witnesses, have all informed the court that the Reyes lease is by far the best of them all, and the Reyes lease is on the Dominguez field which is a better field than the Carson field. Therefore, if our calculations show a certain figure for Dominguez Estate, it is conservative because it is applying the same yardstick that we have established by using the inferior field to the better field.

Mr. Mackay: If your Honor please, may I be heard just a moment on just how Carson was such an insignificant amount? It was solely to conserve

(Testimony of Roger F. White.)

the time of the Court in argument. We stipulated a value, at which time I assumed that that would be taken and your Honor put that in with consent [462] of both counsel into the balance sheet along with other values of assets. Now, if they are going to use this oil royalty which is stipulated to at \$285,000.00 for any other purpose than they would use our stipulated fair market values of other assets—and I refer to real estate, I refer to \$7,000,000.00 of stocks and bonds which we did not discount at all under the blockage rule, we took merely the quoted prices to arrive at a value, and if that were taken and reflected in the stock it would make quite a few dollars difference—now, if this is permitted and they are to make something out of that stipulated value and if they are going into the question of how we arrived at the stipulated value, we want the same privilege, and we offer to show and we will show it is worth a whole lot less than that stipulated value because it could not have been sold for that at that time.

Mr. Melville: Up to this time we have not gone back of the stipulated figure of \$285,000.00, but the record will show that the plaintiff put on two witnesses to testify as to the value of the oil royalties in the Carson Estate Company. The first witness, as I recall, testified to a value of \$174,000.00, and the second witness to a value of \$283,000.00, and it was very quickly thereafter that petitioner and respondent agreed upon a fair market value of \$285,000.00, which is substantially the figure that

(Testimony of Roger F. White.)

petitioner's own witness testified to. That is the reason that that figure was stipulated [463] to, because the government felt that there was no need to call a number of witnesses and burden this court with testimony as to the fair market value of the oil royalties in the Carson Estate Company in view of the fact that petitioner's own witness testified substantially to what the respondent's witness would testify to. Having stipulated it, it seems to me that we have positively established the fair market value for the purposes of this case on the oil royalties in the Carson Estate Company case, and it is not out of place, it seems to me, to do the mathematical calculations which, if the Judge would want them done after the case is submitted, we are simply doing them now to save his Honor any inconvenience in having them done later.

Mr. Mackay: If your Honor please, it would seem to me that a mathematical computation as a part of the evidence then would be a nullity. Is it possible we are going to get—the rebuttal evidence in this case may change the basis of his mathematical computation. The trouble with the government, if your Honor please, is that they are trying to adopt a yardstick, that is what they want to try to do, but yet they are comparing apples with peanuts, or something else. Your Honor will recall there was considerable difference between the two properties, not only with respect to the prices of the oil, but other factors. It seems to me we are taking up too much time and wasting time. [464]

(Testimony of Roger F. White.)

The Court: I am disposed to let the evidence in, although I think its materiality is quite doubtful. I think I understand what he is trying to do. I will overrule the objection and he may testify.

Mr. Mackay: Note an exception.

The Witness: There was a stipulated value of \$285,000.00 as the fair market value of the royalty interests of the Carson Estate Company. There was also a stipulation that the future expected income from these royalties was \$476,542.00.

Mr. Mackay: What is that number?

The Witness: \$476,542.00. There was also an estimate of oil reserves for these properties of 398,796 barrels, which would result in an average price of oil of \$1.19495 for the estimated oil reserves.

Mr. Mackay: May I ask counsel if this is based upon the estimate of oil reserves for Carson? If they are not going to accept the stipulation as the fair market value, I rise now to withdraw the stipulation.

The Court: I think I understand what they have done here. He is showing that while some evidence indicates that the value of \$9,000,000.00 was some \$3,000,000.00 above the yards'isk used, in valuing the oil in the ground, that in pumping it out and so on, that amounted to some 40 cents a barrel and he is showing here that your other calculation [465] amounted to \$1.94 per barrel. Is that about what it amounts to?

The Witness: No, it really amounts to a value

(Testimony of Roger F. White.)

of \$.7146 per barrel for the estimated oil reserves in the Carson Estate Company properties.

The Court: Does that complete your answer?

The Witness: No. I was trying to analyze these figures to see what the ratios were, and, in summary, the Carson Estate Company's ratio of value to expected future income was 59.8058 per cent. In other words, he valued an expected income of \$476,000.00 at \$285,000.00, which is about 59 per cent. Applying the same ratio to the estimated future income from the Dominguez Estate properties, we would arrive at a value of \$5,400,451.00 as the value of the Dominguez Estate Company properties, giving effect to the difference in the average price of oil.

By Mr. Melville:

Q. Now, is that what you would call the percentage of ultimate basis of valuing of oil royalties?

A. Yes.

Q. Did you apply a yardstick now to another method of valuing oil royalties?

A. Yes. The ratio of prices between the Carson Estate Company properties and the Dominguez Estate was .945437. In other words, the average expected price of oil from Dominguez [466] Estate properties was slightly less than that which was anticipated from the Carson Estate Company properties, and applying that factor of 94.54 per cent to the Dominguez Estate Company properties, we would find that the value of the oil in the ground, or the unit value, was 67.5656 cents per barrel as

(Testimony of Roger F. White.)

compared to the 71.465 cents in the Carson Estate valuation. That was all.

Q. Is that latter comparison on the basis of the value per barrel of oil in the ground?

A. That is right.

Mr. Melville: Your witness.

Cross-Examination

By Mr. Mackay:

Q. How much per daily barrel does that figure for the Carson?

A. I don't know. I don't have the barrels per day production on the property.

Q. It is 200, isn't it?

A. Just about 200, I think so.

Q. Did you give any consideration to the average daily production? A. No.

Q. Or the price per barrel? A. I did not.

Q. Why didn't you do that if you were trying to make [467] the yardstick that would help the Court?

A. I am not trying to establish a yardstick. I am just trying to show the basis that would exist on this basis of valuation.

Q. Can you tell if the Carson royalty is equivalent to—withdraw that.

Mr. Paine testified that the Carson royalty was equivalent to 14 per daily barrel—1,400. Now on that same basis, applying that yardstick, what would the Dominguez royalty on a comparable basis be worth?

(Testimony of Roger F. White.)

A. I don't know. I have not made that calculation.

Q. Well, can you do it?

A. Well, I probably could yes. I would have to have——

The Court: I don't understand this witness is offered as a valuation expert but merely as one to work out a mathematical problem.

Mr. Melville: I believe that is correct, your Honor. All I have attempted to qualify him for is as a person who knows how to add, subtract, multiply, and divide. He has done it and he has put in his testimony. When they go beyond that they are going beyond the scope of the direct examination.

Mr. Mackay: I think not, your Honor.

The Court: I think if you have another problem you want him to work out which ties in with some other figures, you may do so. [468]

Mr. Mackay: I certainly have a right to ask him what he took into consideration and why he did not take other things.

Mr. Melville: If counsel wants him to work other calculations, I think he ought to furnish him with a calculating machine.

The Court: Counsel may proceed with the cross-examination of this witness.

By Mr. Mackay:

Q. Now, Mr. White, if the average daily production of Carson was 200 barrels a day, daily

(Testimony of Roger F. White.)

average production 200 barrels, and if it had a fair market value on that date of \$285,000.00, what would you say would be the equivalent per barrel?

A. 200 barrels a day divided into the \$285,000.00.

Q. That would give you 1,400? Would you or can you divide, I mean, without a comptometer?

A. Unfortunately, I have used a comptometer so long I am practically helpless without one. (After making computation.) Yes, that is right, the value would be about \$1,475 per barrel.

Q. Can't you check your figures? Doesn't it come out around \$1,400.00?

A. \$1,425.00 per barrel.

Q. \$1,425.00? [469] A. Yes.

Q. Now, if you applied that same ratio of \$1,400.00 per barrel, or \$1,425.00, to the average daily production from the Dominguez, what figure do you get?

A. I don't know what the daily production of Dominguez was.

Q. 1,500 barrels. Let us assume it was 1,500 barrels. A. Assuming it is 1,500 barrels?

Q. Yes.

A. I don't know whether that was the production of that lease.

Q. Let us assume that the average daily production was 1,500 barrels.

A. 1,500 barrels, and you want to multiply it by \$1,425.00?

Q. Yes.

(Testimony of Roger F. White.)

A. That appears to be \$2,137,500.00.

Q. Yes. A. Quite so.

Q. So, then, if you make a comparison there as between the two on the average daily production, you get a fair market value of Dominguez?

A. I didn't make that comparison.

Q. Wait a minute. I am asking you. Please wait. A. All right. [470]

Q. If you make the same comparison as to the average daily production, then you arrive at a fair market value of the Reyes lease of \$2,137,000.00, that is right, isn't it? A. That is right.

Mr. Mackay: That is all.

Mr. Melville: Just a moment, please.

Mr. Mackay: Just a moment. I have one more question.

By Mr. Mackay:

Q. Mr. White, doesn't this show you that this sort of study can be awfully inconsistent?

A. Well, I have been at this business for about 25 years, and I quite agree with you. I don't agree with your barrels per day method where you have different properties.

Mr. Mackay: That is all.

Redirect Examination

By Mr. Melville:

Q. I would like to have you explain that last. You are familiar with the daily production per day, that is, the production per day method of valuing, are you? A. Yes, sir.

(Testimony of Roger F. White.)

Q. Does that apply fairly to oil properties which are under curtailment? A. I don't—

Mr. Mackay: If your Honor please, I object to that. [471] The witness is not qualified to answer. Is he being put on here as an expert witness on valuations?

Mr. Melville: No, but you asked him a question which would seem to indicate you recognized his ability.

Mr. Mackay: No, I did not. I merely—

The Court: I will sustain the objection to the present question. Off the record.

(Discussion off the record.)

Mr. Melville: No more questions.

(Witness excused.)

Mr. Melville: Mr. Evans.

LOUIS H. EVANS,

called as a witness for and on behalf of the respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your name, please?

The Witness: Louis H. Evans.

By Mr. Melville:

Q. Will you state your qualifications, Mr. Evans?

A. You mean my education, training, and experience?

(Testimony of Louis H. Evans.)

Q. That is right.

A. I wonder if I might submit a certificate which I usually place in my valuation reports in private practice which [472] outlines them?

Mr. Melville: I have given counsel a copy of his qualifications.

The Court: We will suspend for a brief recess.

(A short recess.)

By Mr. Melville:

Q. Will you state your qualifications?

A. I was educated at Granville, New York, High School; Cornell University, 1908; eight years in Philippine Insular Service. 1918-1919, First Lieutenant, Engineers, United States Army. 1919-1921, Chief Engineer, Magnolia Oil Company in Mexico (Cia De Inversiones "Aztlan" S.A.). 1921-1922, Valuation Engineer, Oil and Gas Division, Income Tax Unit, Washington, D. C., California and Mexican properties. 1923 to 1938, private practice in Los Angeles.

As appraisal engineer with the Treasury Department I established the oil reserves and values on all of the properties of the Standard Oil Company of California, Union Oil Company, General Petroleum Corporation, C. C. M. O., Associated Oil Company, Honolulu Oil Company, and many others.

I am affiliated with the American Association of Petroleum Geologists and the American Society of Civil Engineers.

There follows a partial list of clients for whom

(Testimony of Louis H. Evans.)

I have done work from 1923 to 1938: California Petroleum Corporation, General Petroleum Corporation, Dabney Oil Syndicate, [473] San Francisco McKittrick Oil Company, California Star Oil Company, Trojan Oil Company, Graham Loftus Oil Company, Oil Royalties, Southern California Edison Company, Wilshire Oil Company, Childs Estate, Dominguez Estate, I. W. Hellman Estate, Gardena Syndicate, Carson Estate, California Cooperative Corporation, Big Ten Oil Company, Surprise Oil Company, B. B. & O. Oil Company, Midway Pacific, Hunt, Weatherwax & Blyth, Marine Oil Company, California Eastern Oil Company, Charles Sumner Young Estate, Caribou Oil Mining Company, Argonaut Oil Company, Visalia Midway Oil Company, Producers Oil Company, Schaff Noble Oil Syndicate, Palmer Union Oil Company, National Pacific Oil Company, Midway Gas Company, Los Angeles Gas and Electric Company, Dominion Oil Company, Signal Royalties, Ventura Fuel Company, E. S. Barnard Company, Baker-Grover Oil Company, Bolsa Chica Oil Corporation, Delaney Producing & Refining Company, Pacific Western Oil Company, Group One Oil Corporation.

For personal details see *Who's Who in Engineering*, 1931-1933 and 1937.

Q. Since 1938, Mr. Evans, what has your occupation been?

A. Since 1939 I have been senior petroleum appraisal engineer for the Division of Assessment Standards, California State Board of Equalization.

(Testimony of Louis H. Evans.)

Q. Mr. Evans, were you ever called upon by the Dominguez Estate Company to make an appraisal of certain of their leases? [474]

A. Several times.

Q. Did you make such an appraisal in 1938?

A. I did, June 30, 1938.

Q. I might ask you at this time, have you received a subpoena in this case? A. I have.

Q. And are you appearing here under subpoena?

A. I am.

Q. I hand you a book and ask you if you recognize it. A. (After examining.) I do.

Q. What is it?

A. A copy of the appraisal report I prepared for the Dominguez Estate Company as of June 30, 1938.

Q. Is it a true copy?

Mr. Mackay: I will stipulate it is a true copy.

Mr. Melville: Very well.

By Mr. Melville:

Q. For what purpose did you make the appraisal in 1938?

A. It was explained to me at that time—I had made a number of previous reports for the company—that a number of the younger members of the Dominguez family were coming in to take an active interest in the affairs of the company and that a report was desired that should describe the oil properties of the company in some detail, giving the past production, well records, past royalties, and

(Testimony of Louis H. Evans.)

it was desired that a valuation [475] be placed upon the property. That is all I know of the purpose for which that report was desired.

Q. Do you know whether or not your appraisal was made for estate tax purposes?

A. I do not know, sir.

Q. Do you know that it was not?

A. I do not. I know nothing more about the purpose of that report than I have stated.

Q. Just for your protection, Mr. Evans, and for the purpose of the record, I would like to have it show that the copy which you identified was obtained from the petitioner and not from your files.

Mr. Mackay: The record may show that Mr. Mackay at the request of Mr. Melville handed Mr. Melville this copy.

By Mr. Melville:

Q. Mr. Evans, do you recognize that an appraisal in 1938 would not be controlling in 1941?

A. Certainly, I recognize that.

Q. Would it have some indication as to the accuracy of appraisals made in 1941?

A. I did not understand the question.

Q. If a geologist or engineer made an appraisal in one year, and two or three years later made an appraisal of the same property, would he start afresh or would he go back to the previous appraisal and bring that up to date? [476]

A. He would be rather dumb if he did not start afresh.

(Testimony of Louis H. Evans.)

Q. Did you or did you not in 1938 appraise the following leases: Reyes——

Mr. Mackay: If your Honor please, I object to the leading question.

The Court: Overruled. He may answer that.

By Mr. Melville:

Q. Reyes, DeFrancis, Manuel, Richfield-Selbar, Continental, Marland, and Carpenter—did you appraise those leases for the Dominguez Estate Company? A. I did.

Q. Are those on the Dominguez oil fields?

A. They were in the Dominguez oil fields.

Q. In the Torrance-Redondo field did you or did you not appraise the Standard-Getty, G.P.-Carson, and C.C.M.O. leases? A. I did.

Q. Did you appraise any other leases at that time? A. I do not recall.

Q. I show you a copy of your appraisal report and ask you to examine that and refresh your memory.

A. (After examining): That is apparently all of the properties which I appraised.

Q. Can you state at this time what value you placed on the leases in the Dominguez Hill in 1938?

Mr. Mackay: If your Honor please, I object to that as incompetent, irrelevant, and immaterial, and as having no bearing upon the issue here. The witness has already testified that a value in 1938 would have no material bearing upon a value in 1941, which your Honor is very well familiar with,

(Testimony of Louis H. Evans.)

and I submit it is entirely incompetent, irrelevant, and immaterial.

The Court: Objection sustained.

By Mr. Melville:

Q. Mr. Evans, have you been furnished with the stipulated figures in this case as to oil reserves and estimated future income from the Dominguez Estate oil properties?

A. I have. The latter statement, as I recall, was estimated probable future income, which was stipulated.

Q. Were you asked to make an appraisal?

A. I was.

Q. Based upon the stipulated figures?

A. I was.

Q. Were you asked to make that appraisal for the purpose of arriving at your opinion of the fair market value at June 5, 1941, of the Dominguez Oil Royalties? A. I was.

Q. Did you arrive at an opinion?

A. I did. [478]

Q. What is it?

A. In my opinion the fair market value of the oil royalties of the Dominguez Estate Company in Dominguez Hill as of June 5, 1941, was \$4,000,000.00.

Q. How did you arrive at that opinion, Mr. Evans?

A. Well, to begin with, I examined the stipulated figures as to the probable future income to

(Testimony of Louis H. Evans.)

be derived from these royalties and decided that the use of the word "probable" indicated a possible element of error in these figures which had been stipulated to as to the future net income. This future net income had been based upon an estimate of reserves, the reserves of oil and the probable rate at which this oil would be produced. Now, to determine the possible element of error in the stipulated figures as to probable future income, it was necessary for the appraiser to consider the conditions obtaining on June 5, 1941.

At that time the oil industry here on the Coast had just begun to feel the impact of our war or defense program. The increase in industrial activity had a rather curious effect, first, in greatly increased demand for heavy crudes and apparently a lessened demand for gasoline and light oil, which was indicated by rapidly decreasing crude oil and fuel supplies and an increase in our light oil and gasoline storage.

California oil fields were being operated under curtailment. The Dominguez oil field, according to the California [479] Conservation Committee, had an effective potential maximum of 87,500 barrels a day, and was actually producing less than 27,000 barrels a day from that Dominguez oil field. There were about 50 to 55 flowing wells. Each had a top allotment and could not be produced in excess of 171 barrels per day. There were around 60 to 65 gas lift wells, producing about 90 barrels a day.

(Testimony of Louis H. Evans.)

The balance of the total of 302 wells were pumping wells.

Now, every petroleum engineer was aware by this time that any estimate of reserves made and based on the production of a field as severely curtailed as that is certainly suspect so far as reasonable accuracy to be obtained.

So, I discounted the tabulation furnished me on the stipulated future net income of the Dominguez royalties at a 10 per cent compound interest rate. The result of that computation was to reduce the total future expected royalties amounting to \$8,666,000.00, to the sum of \$5,003,000.00, and some odd.

I was informed that the price used in determining this stipulated probable future income was based upon the price existing on June 5, 1941. The estimate of future net earnings, then, discounted entirely the law of supply and demand and ignored entirely increasing evidence during those years of a tendency towards inflation.

Weighing all of these factors, it was my judgment and opinion that this present worth value of \$5,003,000.00, and [480] some odd should be reduced by about 20 per cent. Accordingly, \$4,000,000.00, in my opinion, was the fair market value of the royalties of the Dominguez Estate Company as of June 5, 1941.

Q. Now, Mr. Evans, if you assume that the stipulated figures are absolutely correct, what would

(Testimony of Louis H. Evans.)

your opinion be as to the fair market value of the Dominguez oil royalties on June 5, 1941?

A. Obviously, if I had the assurance that they were correct, the value would be \$5,000,000.00.

Mr. Melville: Your witness.

Cross-Examination

By Mr. Mackay:

Q. Mr. Evans, how long did you state you have been up at the Board of Equalization?

A. Since 1939.

Q. And the problem of an equalization board is what it means, to equalize taxes, isn't it?

A. Yes, sir, to attempt to.

Q. What? A. To attempt to.

Q. That is right. You are not concerned there with fair market value, are you?

A. Yes, indeed.

Q. But it is mostly to equalize the taxes? [481]

A. Every year I have to make a determination of the recoverable reserves of each and every oil and gas field in this state, place a fair market value on each oil field, and I then gather from the various assessors, the total assessment figures which they placed upon these fields, and report to the Board the relation between assessed values and fair market values.

Q. Now, Mr. Evans, have you been on this Dominguez property lately?

A. Not since 1941—not since 1939.

Q. Not since 1939? A. No.

(Testimony of Louis H. Evans.)

Q. You are not, then, familiar with its operations, and you were not familiar with its operations in 1939, 1940 and 1941, were you?

A. In what respect do you mean? I have to be familiar with the operations that are going on in every oil field in this state.

Q. Well, you have not checked each well down there, have you? A. Indeed I do.

Q. In Dominguez?

A. I take the Scout Service and get a card every week showing in detail the completion date and all the dope on every well that is completed in the field, and every field.

Q. Are you familiar with the terms of the Reyes lease? [482]

A. The terms of the Reyes lease? No, sir.

Q. You have never read them?

A. No, sir. I think you will find in that certificate a statement that I have not examined into and do not pass upon titles or any of the leases.

Q. Ordinarily, doesn't the terms of the lease have some bearing?

A. Certainly they do.

Q. Now, Mr. Evans, I think you stated that you took the estimated future production, future income, and you discounted that 10 per cent?

A. Yes, sir.

Q. And that brought you down to the present worth figure of something in excess of \$5,000,000.00. Am I stating it correcelty.

A. That is correct.

(Testimony of Louis H. Evans.)

Q. And then after you arrived at that, what factor did you take into consideration when you reduced that present worth to your figure of in excess of \$5,000,000.00?

A. I thought I had explained very, very clearly. I have taken into account the possibility of error in the estimation of reserves, the possibility of error in the price used, and in my opinion a further reduction of 20 per cent was warranted in arriving at that fair market value.

Q. How did you spread that 20 per cent, between what? [483]

A. How did I what?

Q. How did you arrive at that 20 per cent?

A. That was a mental process that I don't know that I can thoroughly explain. It is the result of some 20-odd years of experience in arriving at the value of properties.

Q. So you have used that same method for 20 years or more?

A. Yes, but I vary in the discount which I may make.

Q. What conditions would lead you to vary that?

A. Well, I think if you look that 1938 report over you will find that I was so confident that my estimate of reserves which I had made on the Reyes lease, and so forth, was a minimum that was going to be recovered, that I used no further discount whatsoever, but, on the contrary, on the other leases that I did apply varying factors which

(Testimony of Louis H. Evans.)

in my judgment and opinion would arrive at fair market value.

Q. Well, at that time you did not make an underground—any study of underground conditions, did you? A. What do you mean?

Q. Reservoir conditions, for instance?

A. I certainly got all the information which could be obtained from the Shell and Union Oil Companies as to underground conditions.

Q. At the time you made your estimate in 1938 you did not have that detailed information? [484]

A. I had all that was available at that time.

Q. But you did not have the detailed information, did you?

A. I had all the information which the Shell Company could give me.

Mr. Melville: I might point out, your Honor, that through the opposition of Petitioner's counsel, his appraisal as to 1938 was kept out of the record. I don't believe, in view of the fact that it is not in the record, his method of arriving at it is particularly important.

Mr. Mackay: Well, if your Honor please, he referred to reserves—I will pass that.

The Court: You withdraw the question?

Mr. Mackay: Yes.

Mr. Melville: I will be glad to stipulate in the record his entire 1938 report, which consists of only two pages, the summary.

Mr. Mackay: I think that is to generous.

(Testimony of Louis H. Evans.)

By Mr. Mackay:

Q. Do I understand you to say that in your opinion the fair market value of the Reyes lease of the oil royalty on the Dominguez Estate Company was around \$4,000,000.00?

A. \$4,000,000.00 is the figure I testified to.

Q. Do you arrive at that before taking into consideration income taxes? [485]

A. Certainly I do.

Q. I beg your pardon? A. Certainly.

Q. So that is your figure arrived at before you take into consideration income taxes?

A. Yes, sir.

Q. Now, do you mean by that that the buyer would not consider income taxes in arriving at the fair value? [486]

A. It is my experience that both the buyer and the seller today are very acutely aware of income taxes, and that I do consider the effect of income tax on values. It has a rather curious effect. There would be a lot more homes available for sale in this town today if people were not afraid to sell them at enhanced values because of the terrible income tax you have to pay on them. So, the effect of the income tax, as I analyze it, is to increase values rather than to reduce them.

Q. Isn't it true that the price which the investor is willing to pay for a property is determined on the basis of the future net yield after the payment

(Testimony of Louis H. Evans.)

of tax on income and proper provision for the return of capital?

A. Will you state the question again?

Mr. Mackay: Please read it, Mr. Reporter.

(The question was read.)

The Witness: I do not use it that way.

By Mr. Mackay:

Q. Well, you were trying to put a value on the future expected income, weren't you?

A. Yes. I find myself, and you will too very quickly, in a very curious anomalous position if you try to take in income tax in arriving at the value of a property. I know that certain appraisers do in the case of a corporation before capitalizing income consider that as an element of value [487] of the property and do deduct the income taxes. The appraiser that does that and gets on the witness stand is going to be forced to admit that he can arrive at an indefinite number of values. I can just cite the case of two buildings identical and similar in every respect, one owned by a corporation and the other by an individual, and you get two different answers for the same or similar thing. I do not propose ever to be asked to use income taxes in consideration of the value which I derive from income.

Q. Now, Mr. Evans, taking into consideration the estimated future income, let us assume that the taxes were 95 per cent and that on every dollar

(Testimony of Louis H. Evans.)

you got back from that production you had to pay 95 per cent to the Government, would that have any effect upon your value?

A. Not as to the fair market value.

Q. It would not? A. No.

Mr. Mackay: That is all.

The Court: Is that all from this witness?

Mr. Melville: I think I have one question, your Honor.

Redirect Examination

By Mr. Melville:

Q. If, as Mr. Mackay has suggested, a willing buyer took into consideration taxes in arriving at the price which [488] he would be willing to pay for a particular piece of property and if the willing seller of that property took into consideration the taxes in arriving at the price which he would be willing to accept for that property, what would the result be?

A. It is an old, old question. I had it in a very practical manner a number of years ago. One of my clients had asked me what price he should arrive at to buy or sell his partner out. There is no such price when you come to take income tax into consideration. The fair value would have been \$900,000.00, but he could not afford to buy it for more than \$600,000.00—let me see if I get this thing straight—he could not afford to sell for less than \$1,200,000.00, and he could not afford to buy at a price of \$900,000.00, or some such figure as

(Testimony of Louis H. Evans.)

that. When you get income tax mixed up in a question of value of property everything goes hay-wire.

Q. And in that particular case you just cited, was there a sale consummated? A. No.

Q. All right. If there is no sale consummated between the willing buyer who takes income tax into consideration to arrive at the price which he will bid—— A. Hold it.

Q. I will start over again, if you wish, Mr. Evans. A. If you will.

Q. If the willing buyer in arriving at the price which [489] he is willing to pay or bid for a particular piece of property takes into consideration income taxes, and if the willing seller in arriving at the figure which he would be willing to accept takes into consideration income taxes and there is a wide variance between the bid price and the asked price, does either price establish, in your opinion, the fair market price?

A. No, the fair market price is the value which will obtain when the sale is made.

Q. Both of them absorbing their own income tax problems? A. Yes, sir.

Mr. Melville: No more questions.

Mr. Mackay: There are no more questions.

(Witness excused.)

The Court: We will suspend at this time until 2:00 o'clock.

(Whereupon, at 12:20 p.m., a recess was taken until 2:00 p.m. of the same day.) [490]

Afternoon Session—2:00 p.m.

Mr. Melville: Call Mr. Webb to the stand.

The Court: You may come forward.

EDWARD C. WEBB

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your name, please?

The Witness: Edward C. Webb.

By Mr. Melville:

Q. Mr. Webb, what is your business?

A. The oil business.

Q. And are you employed? A. Yes.

Q. By whom?

A. General Industries Corporation.

Q. What position do you hold there?

A. President.

Q. And what business is the General Industries Corporation engaged in?

A. Development of its oil properties.

Q. Has that corporation ever bought oil royalties? A. Yes.

Q. Has it sold oil royalties? [491]

A. Yes.

Q. Is it engaged in business in Los Angeles?

A. That is right.

Q. How long have you been connected with this business? A. Since 1930.

Q. In connection with that business, Mr. Webb,

(Testimony of Edward C. Webb.)

have you found it necessary to value oil royalties?

A. Yes.

Q. When you value oil royalties, do you rely upon the information given to you by geologists and oil engineers? A. Yes.

Q. You have had experience, have you, in translating into fair market value the data that the oil geologists and engineers furnish you?

A. Yes, I have had experience in translating their reports into recovery values.

Q. And into a determination of what the willing buyer and the willing seller would trade at?

A. Yes.

Q. Mr. Webb, have you been asked to study the facts that have been stipulated in this case, the Cotton case? A. Yes.

Q. Did you study those with a view to arriving at an opinion as to the fair market value of the oil royalties of the Dominguez Estate Company?

A. No. My opinion on that is fixed by the prevailing market value at the time the transaction took place.

Q. You may have misunderstood my question. For what purpose did you study the facts that were given to you that are stipulated in this case?

A. To determine the location of the property as to its structure.

Q. And did you consider the amount of oil royalties that are anticipated to be received in the future, starting in 1941?

(Testimony of Edward C. Webb.)

A. I saw the estimate. I don't know who it was prepared by.

Q. I show you what has been marked as Joint Exhibit 11-K (2), which is the summary of probable future royalties and income from the oil properties of the Dominguez Estate Company as of June 5, 1941. Have you see the figures on that exhibit before?

A. I believe Mr. Grimes showed me these figures in my office.

Q. When Mr. Grimes showed you those figures, was it for the purpose of getting from you an opinion as to the fair market value of oil royalties in the Dominguez Hill as of June 5, 1941?

A. I believe that was the purpose.

Q. And did you express—did you give consideration [493] to the figures that were furnished you?

A. No, I did not.

Q. Did you express any opinion with respect to the value of oil royalties as of June 5, 1941?

A. Yes, I expressed an opinion as to the market value.

Q. And what opinion did you express?

MR. MACKAY: I object to that, your Honor. I don't think the witness is qualified to give an opinion.

THE COURT: Well, I doubt the competency of the question as framed. I suppose you are leading up to asking him to express an opinion, is that correct, Mr. Melville?

(Testimony of Edward C. Webb.)

Mr. Melville: Well, off the record, your Honor.

The Court: Off the record.

(Discussion off the record.)

Mr. Melville: I will withdraw the question, your Honor.

The Court: Very well.

By Mr. Melville:

Q. Mr. Webb, on the basis of your experience, do you have an opinion as to what oil royalties bought and sold for in 1941? A. Yes.

Q. Do you have an opinion as to what oil royalties would be bought and sold for as of June 5, 1941?

A. Yes. [494]

Q. On what basis, in your opinion, would oil royalties be bought and sold for as of June 5, 1941?

Mr. Mackay: I object to that as incompetent, irrelevant and immaterial, and the witness not being qualified to answer, too general.

The Court: The question seems to be rather general but we will permit him to answer. The objection will be overruled.

The Witness: Well, you see, you are covering a rather broad and general survey there. Every field in the United States has different producing conditions, different recovery conditions, and different demand for the royalties, and unless you specify the field particularly I could not give you

(Testimony of Edward C. Webb.)

an answer that would be in any way enlightening on that question.

By Mr. Melville:

Q. Thank you, Mr. Webb. That is a good point. I am referring to the Dominguez Oil Field. Are you familiar with the Dominguez Oil Field?

A. Yes.

Q. Have you ever heard of the Reyes lease?

A. I am not familiar with the leases particularly. I am familiar with the field and its reputation and the general character of it.

Q. What is its reputation? [495]

A. Considered among what we call the Class A fields.

Q. One of the best? A. Yes.

Q. Now, then, going back to the other question, do you have an opinion as to what a willing buyer and a willing seller would have agreed upon as the market price or fair market price of oil royalties from the Dominguez field as of June 5, 1941?

A. Yes.

Q. What is that opinion?

Mr. Mackay: I object to that, if your Honor please, as incompetent, irrelevant and immaterial, and no proper foundation laid, too general, not within the issues of the case.

The Court: I am inclined to think that the witness may have shown that he is not qualified to answer as to the Reyes lease unless you perhaps

(Testimony of Edward C. Webb.)

show him these maps and call his attention to the location of the field that we are dealing with.

By Mr. Melville:

Q. Here is a map, Mr. Webb, that is marked Joint Exhibit 17-Q. This diagonal piece with all these lines in it is the Dominguez field, and the part here is the Reyes lease (indicating). All of the properties on this map circled in red constitute leases which belong to the Dominguez Estate Company.

A. Are they part of the interests involved in this case? [496]

Q. They are part of the oil royalties which we are trying to value in this case.

A. Is this particularly here a part of it (indicating)?

Q. That is a part of it, that is a part of it, that is a part of it, that is a part of it, and that is a part of it (indicating). Now, on this they have a joint interest with the Carson Estate Company, this little piece up here (indicating).

Now, on Joint Exhibit 18-R, these five pieces, this small one here, this larger one, these two and this little one over here (indicating) all are Dominguez Estate Company properties which we are trying to value.

A. In the Torrance Field?

Q. That is right. This is in the Wilmington Field and a very little bit is represented by that

(Testimony of Edward C. Webb.)

small square. This Joint Exhibit 20-T is in the Hildon-Caminole-Victory Field (indicating).

Mr. Mackay: If your Honor please, I object to the question. It is a leading question.

Mr. Melville: I am explaining the exhibits. As counsel knows, I was not furnished a copy of these exhibits——

The Court: You need not argue, gentlemen. I will overrule the objection.

Mr. Mackay: I will withdraw the objection to the maps. [497]

By Mr. Melville:

Q. This map, Joint Exhibit 20-T, is a map of the Hildon-Caminole-Victory Field, and the Cross-Hatching represents that the properties here are jointly owned by Dominguez and Carson. I believe the evidence shows, and I think I am quoting correctly when I say, that 90 or 75 per cent of the oil royalties that we are dealing with here are represented in this one Reyes lease right here on this map (indicating); 90 to 95 per cent of the oil royalties that we are valuing are represented by this one lease in the Dominguez Hill.

A. I am not enough familiar with the other royalties concerned to express an opinion anyway at Torrance and Wilmington. There have been some very wide and fluctuating conditions in those two fields.

Q. Are you willing to testify as to only the Reyes lease?

(Testimony of Edward C. Webb.)

A. Yes, I am willing to testify as to what I think the fair market value would have been for it at that time, what I as a broker and dealer could have sold it for.

Q. I think that is what we are after, so I will ask you the question, what, in your opinion, could the oil royalties involved now, only with respect to the Reyes lease, have been sold for as of June 5, 1941?

Mr. Mackay: Just a moment. If your Honor please, [498] I object to that as incompetent, irrelevant and immaterial. It has not been developed that this witness knows anything about the stipulations and the exhibits or that he has shown sufficient familiarity with the property to qualify him as a witness on an estimate which this Court could depend on for an opinion. I think it is incompetent, irrelevant, and immaterial.

Mr. Melville: Your Honor, it seems to me that there are two ways of approaching the problem that we have. One is to call geologists and engineers who know how to go out and determine the amount of oil in the ground, approximately, and the rate of exhaustion, and they get all through and they arrive at a total anticipated income, and by applying certain discounts they give an opinion as to what they think the fair market value should be. Another way to approach our problem, it seems to me, is to call a man who does not know as much about the oil properties, perhaps, as the engineer who has worked over them, gone over the ground

(Testimony of Edward C. Webb.)

day by day over a period of years, but who has dealt in the oil royalties of good fields and bad fields and has seen the buyer lay out his hard cash to buy an oil royalty on a certain basis, a man who has seen the seller accept that money in exchange for his oil royalties. That, it seems to me, is just as good a yardstick for valuing the fair market value of oil royalties, if not a better one, than the engineer who determines how much [499] oil is in the ground and how much the willing seller should ask for it, whether or not he can get it.

The Court: Well, the difficulty with your question as now phrased is that I am in some doubt as to just what you are trying to prove by this witness. Now, I don't understand that he is being presented as one who has gone upon the Reyes lease and made all of the appropriate tests for determining the value of the property which he saw, nor do I understand that he has been shown the basic stipulated facts in this case as they pertain to the Reyes lease, so that you are in a position to ask him to express an opinion as to the fair market value of the estimated probable total less reserves, or the estimated royalty, and how much will be secured from it. I don't say that critically, Mr. Melville, but I am only trying to find out for the purpose of ruling upon this objection just how we have this, just what you are trying to prove by him.

(Testimony of Edward C. Webb.)

Mr. Melville: I will be glad to withdraw the question, your Honor, and try again.

The Court: Very well.

By Mr. Melville:

Q. Mr. Webb, do you deal in oil royalties on the payout basis?

A. Well, of course—let me explain that. I have not dealt in royalties since 1940. That was the last activity [500] our company had so far as buying, trading, or brokering royalties, at the close of 1940. Acting in the capacity of a broker, and also as a distributor of them, and as a purchaser for our own ownership, our own investment, we used both methods. The demand was so great for royalties along at that period—

Mr. Mackay: If your Honor please, I object to that.

The Court: Overruled. He may proceed.

A. (Continued) Well, your Honor, I may digress a little bit here from the legal side of this question. I am just trying to explain what my position in the business has been so everybody will understand what my testimony is.

The Court: You may proceed.

A. (Continued) On this, what we call the short payout stuff, that is, where you have flush production and rapid return of the money, the recovery never was so paramount and important in the purchase of that type as the stuff where it extended over a longer term of years. Where it ran into a

(Testimony of Edward C. Webb.)

longer term of years, anywhere from six to twelve years, of course the matter of recovery at deep sand potentialities all entered to quite a large extent in our decision on whether we would handle it or sell it. This particular type of royalty under question here, of course, would be one that I would consider a long term pay-out, and, naturally, recovery would be an important factor if we were at that time considering the royalty for purchase and sale. But to qualify the first part [501] of my answer there, I was going to say that the demand was so great at that period by the buyers and investors for royalties that they were willing to take the better class pools, what we call the Class A pools, on an extremely long term pay-out basis, and some consideration was given at that time, some thought, to the possibility of a substantial increase in the price of the oil, a substantial increase, perhaps, in the allowed production from the wells, which, of course, would have shortened the pay-out period. Quite a considerable consideration was given to the deep sand possibilities and they were willing to pay some speculative value for that.

Now, as to whether or not we used any one particular yardstick in determining our basis for purchasing, depended somewhat upon the attitude of the buyer at the time. It was not so much in that period what you had to sell as it was what you could get to sell. There didn't seem to be much difficulty in selling it. The distribution and sale of the royalties were governed by the proper State

(Testimony of Edward C. Webb.)

and Government agencies which supervised the selling price and the manner of distribution.

By Mr. Melville:

Q. Well, on good oil royalties, such as we have represented in the Reyes lease, what were they being bought and sold at on the pay-out basis in 1941?

Mr. Mackay: I object to that as incompetent, irrelevant, and immaterial, no proper foundation laid. [502]

The Court: If he knows he may answer.

The Witness: Well, if we could have secured a royalty of that quality and in that particular lease, it is my opinion that we could have sold it easily on one hundred times its monthly pay-out or its monthly return.

Mr. Melville: No more question. [503]

Cross Examination

By Mr. Mackay:

Q. Mr. Webb, you have never been on the property? A. No, never have.

Q. You have never made a study of the lease?

A. No.

Q. Or the lease document?

A. No, I have not seen the lease document.

Q. Do you know the lease conditions?

A. Well, not in detail.

Q. You have never studied the lease, have you?

A. I know the reputation of the field.

(Testimony of Edward C. Webb.)

Q. Just the reputation? A. Yes, sir.

Q. Do you know whether the production was declining about this time or inclining?

A. No, I don't know.

Q. You don't know anything about that?

A. No. I would assume that it was declining.

Q. You would assume it was declining?

A. That is, it was several years old.

Q. You have made no investigation to determine that, have you? A. No.

Q. Did you, in your figure, take into consideration [504] income taxes?

A. No, my opinion there was before taxes.

Q. Before taxes? Well, assume that out of every dollar that is recovered, Uncle Sam would take 95 per cent, would that affect the value, in your opinion?

A. Well, I don't think it would, due to the fact that the taxpayer's status would be different in practically every case. One man would be up against a 95 per cent condition where another might be exempt.

Mr. Mackay: That is all.

Mr. Melville: No more question. You are excused.

The Court: May I ask the witness one question? I don't understand what you mean by 100 times each monthly return. If you take a group of leases having a monthly return of, say, \$60,000.00 a month in 1942, but with an estimated return of less than

(Testimony of Edward C. Webb.)

half of that 10 years later, where do you get your 10 times monthly return under those figures?

The Witness: Well, your Honor, technically it is a very erroneous way to figure values. It is a method that is used in royalty trading in the business quite generally, more particularly as concerns the short pay-out leases, the idea being at the time to probably estimate how soon you might expect a return of your cost, based somewhat upon the anticipated life of the flush production before the wells go into their secondary production stage or life. [505]

Mr. Melville: Your Honor, I think I can clear this point up.

Redirect Examination

By Mr. Melville:

Q. This Exhibit 11-K (2) shows that according to the stipulation of the parties the Reyes lease would receive during the last seven months of 1941 \$368,645.00. Do you see that figure there? That is up to May 31st.

A. Of course, the way we calculated that to determine what the average monthly pay-out was, we would probably have taken the previous 12 months' production, taken the average for the previous 12 months or some such period, and then used our basis of calculation upon that average per month during that period. Of course, you might have one particular month that might be very high and

(Testimony of Edward C. Webb.)

another very low due to some peculiar local condition or mechanical trouble, and so on.

Mr. Melville: May I suggest, your Honor, that we give the witness the income according to the stipulation for the year 1940 and have him use that—the last 12 months' average monthly pay-out—and work out his problem?

The Court: You have the stipulated income from the lease only?

Mr. Melville: I believe we have, your Honor.

The Witness: I examined before coming up here——

The Court: You better wait a moment until a [506] question is asked you.

The Witness: I didn't know whether you wanted me to answer your question.

The Court: I did not care to interrogate you, sir. Wait until counsel asks a question.

The Witness: I see.

Mr. Melville: No wonder I could not find it, your Honor. It is not in the stipulation. The future figures out but not the past figures by leases.

The Court: I did not remember having seen it. Do you have any other questions, Mr. Melville, of the witness?

Mr. Melville: No, your Honor.

Mr. Mackay: No, your Honor.

The Court: I have no desire to cross examine him myself, gentlemen. I was just merely trying to get an explanation of that answer of his as applied to

this case, that is all. You may stand aside, Mr. Webb.

(Witness excused.)

Mr. Melville: Call Mr. Pemberton, please.

JOHN R. PEMBERTON

called as a witness by and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows: [507]

Direct Examination

The Clerk: Your name, please?

The Witness: John R. Pemberton.

By Mr. Melville:

Q. Mr. Pemberston, what is your business?

A. I am a consulting petroleum geologist and engineer.

Q. Will you please state your educational and professional qualifications?

A. Yes. I was graduated from Stanford University in 1909 as a geologist, and worked for the United States Geological Survey in a portion of 1909 after graduation. I was an instructor in geology in Stanford University in 1910. I was then employed as a geologist by the Argentine Government for five years in land classification. I returned to this country and entered the employ of the Ventura Refining Company, a producing company in California. I then went to Oklahoma and was engaged in the business of exploration and

(Testimony of John R. Pemberton.)

geological work, and later development and production of oil for seven years in the Midcontinent. I then returned to California and was employed by the Petroleum Securities Company and the Pan-American Petroleum Company for eight years, during time I had charge of drilling and producing oil, management of properties, and also the geological work. In 1932 I was chosen as what is known as the Oil Umpire for the petroleum producing business within the state [508] and held that office for eight years. That work involved keeping statistics on production of crude oil in the state and the issuance of so-called allocation schedules of curtailment, the object of which was to keep the supply of crude oil commensurate with the consumptive market demand. Since 1940, the early part of 1940, I have been in business for myself.

Q. Have you had experience in valuing oil royalties?

A. Yes, sir; a great part of my work has been and is now the determination of value for market value of royalties, producing properties, and oil interests.

Q. Have you testified in court as to the value of oil properties and oil royalties?

A. Yes, sir.

Q. Were you recently retained by our worthy opponent, Mr. Mackay, to testify in a case as a witness on oil royalties and oil property valuation?

A. It was in connection with the value of a

(Testimony of John R. Pemberton.)

property as of March, 1913, for the determination of capital gain or loss.

Q. It was an oil property?

A. Yes, sir, an oil property.

Mr. Mackay: Not an oil royalty?

By Mr. Melville:

Q. You have seen the exhibits that have been [509] introduced as part of the stipulation in this case insofar as they would give you, or insofar as you needed to go into, the factors to determine the fair market value of the oil royalties of the Dominguez Estate Company as of June 5, 1941?

A. Yes, sir, I have seen them.

Q. Did you study them? A. Yes, sir.

Q. Did you study them with a view to formulating an opinion as to the fair market value of the Dominguez Company's oil royalties as of June 5, 1941? A. Yes, sir.

Q. Did you form an opinion?

A. Yes, sir.

Q. What is that opinion?

A. It is my opinion that it was worth \$4,000,000.00.

Mr. Melville: No more questions—yes, I will ask a few more questions.

By Mr. Melville:

Q. Did you check after you arrived at your opinion of \$4,000,000.00—did you check your method of appraisal with the same method of appraisal which has resulted in actual sales?

(Testimony of John R. Pemberton.)

Mr. Mackay: I object to that, your Honor, as a leading question.

Mr. Melville: I asked him if he did. [510]

The Court: Overruled. You may answer.

A. Yes, sir, I did.

By Mr. Melville:

Q. Would you explain to the court the sales you checked it with and the result of your check?

A. A number of years ago, in 1936, to be explicit, I appraised a property similar in many respects to the Dominguez Estate's properties in the Ventura Avenue oil field and determined a value of that property for an inheritance tax case. The appraisal was accepted by the government and by the court and the tax was paid. The taxpayers did not have enough money to pay the tax and it was necessary for the taxpayers to borrow money or sell the property to get the money to pay the taxes, apparently. They elected, rather than to borrow, to sell, and they sold an interest in the royalty. They sold a 35 per cent interest of a one-eighth royalty, using my appraisal as a basis to determine what the value of the interest sold was as of the date of sale. In checking that against the sales price I arrived at a factor or a percentage, you might say, which would be a percentage which had been applied to the value that I had determined in order to determine the fair market value by the purchaser and the seller, and applied that percentage to the value that I worked out for the Dominguez

(Testimony of John R. Pemberton.)

Estate property, using the same method of figuring in both cases, and arrived as a [511] figure of close to \$4,000,000.00. To be explicit, the figure that I reached was \$3,871,000.00. My opinion is that market conditions for royalties and money were very much easier in 1941 than they were in 1938, and that had this interest been sold under those conditions it would have received \$130,000.00 more to make an even \$4,000,000.00.

Mr. Melville: You may cross examine.

Cross Examination

By Mr. Mackay:

Q. What price did it sell for?

A. What is that?

Q. What price was that sale you had, Mr. Pemberton?

A. The property was sold for—the interest was sold for \$1,842,105.30. That was, however, 35 per cent of a one-eighth royalty.

Q. What were the estimated reserves in that?

A. The estimated reserves as of that time?

Q. Yes. A. 8,600,673 barrels.

Q. What did that figure out per barrel in the ground? A. 74.19 cents a barrel.

Q. You are sure that is not 60.4?

A. No, 74.19—oh, excuse me. That is the value that the seller had set up. In this sale the seller took a capital loss of \$391,000.00. The cost to the buyer per barrel [512] was 61-1/3 cents, approximately.

(Testimony of John R. Pemberton.)

Q. That oil was 1.57 per barrel oil, wasn't it?

A. No, I believe not.

Q. Oil, gas and gasoline, I am talking about.

A. It probably was, yes, the revenue, yes.

Q. At \$1.57? A. Yes, it probably was.

Q. And so you used that as a comparison with this, Mr. Pemberton? A. Yes, sir.

Q. Now, is it not a fact that the lessee in that deal got a very substantial modification of the lease terms?

A. No, I know of no changes in the lease. If they occurred, I never heard of them.

Q. Do you know that there were not?

A. I have appraised that same lease just about a month ago and I ran across no changes in the lease.

Q. You really don't know whether there were some lease modifications in that deal?

A. I do not know that there were not, but I have—I am sure that there were none of any consequence, affecting the value in any manner.

Q. If you don't know there were any, how do you know they did not affect values?

A. All the terms of the lease that affect value are [513] the same now as they were in 1936.

Q. Is it not a fact that there was a modification there with respect to further drilling by the lessee, and that the lessee wanted to get relieved of those further drilling requirements?

A. I don't know about that.

(Testimony of John R. Pemberton.)

Q. You didn't go into that when you made that valuation? A. No, I did not.

Q. So, Mr. Pemberton, then, you are preparing that sale of \$1.57 with \$1.13 oil in this case, aren't you?

A. No, I am not comparing them.

Q. You are not comparing them?

A. No.

Q. I understood you to say that one of your tests was the deal you made—the value you placed on there and the sale that was made.

A. Yes.

Q. And you testified that was \$1.57 oil? Now, in the facts here it has been stipulated it is \$1.13 oil in this case. Do you think that is a fair comparison? Wouldn't you get more for \$1.57 oil than you would for \$1.13? You know that is right, don't you, Mr. Pemberton?

A. Yes, of course.

Q. It would make quite a difference? [514]

A. In this case I have had nothing to do with barrels. I have been furnished with a stipulated schedule of future earnings by years, a certain amount of earnings by years, and I have determined that the fair market value of those earnings is \$4,000,000.00. Now, as to how many barrels it represents, I have not been advised.

Q. You have not been advised as to the number of barrels?

A. No, nor how many dollars per barrels that represents.

(Testimony of John R. Pemberton.)

Q. Let me ask you this question: If your oil was worth 60 cents in the ground, based upon the \$1.57 value, as you stated, what would this at \$1.13 be worth in the ground?

A. Well, I don't—

Q. You would not have an opinion on that?

A. I don't grant you can make comparisons of that kind.

Q. All right. When were you down on the Dominguez lease?

A. Oh, I was through there about four or five months ago.

Q. Not to make an examination?

A. No, before I heard of this controversy.

Q. And since you heard of this controversy you have not been down there? A. No.

Q. You have not studied the well production?

A. No.

Q. You have not studied the operations down there? A. Now?

Q. Yes. A. No.

Q. Not for this case? A. No.

Q. You merely took the figures here that were presented to you in this stipulation?

A. Yes.

Q. And you did not see any barrels in there? You just saw the revenue and made your valuation on that? A. That is correct.

Q. Did you regard that revenue shown on the stipulation as absolutely definite revenue?

A. Yes.

(Testimony of John R. Pemberton.)

Q. You felt that was very definite revenue, did you?

A. Well, it was a schedule showing some \$9,000,000.00 spread over 35 years, stipulated to by both parties in this controversy, which established adequate grounds for me to assume it was solid and basic and fundamental.

Mr. Mackay: That is all.

Redirect Examination

By Mr. Melville:

Q. Mr. Pemberton, on the basis of your experience in [516] valuing oil royalties, were you given in the stipulations that you received all of the information which you thought was necessary in order that you would not have to go down to the oil fields to look them over?

A. Well, I can answer that, yes, because when I make a valuation of a royalty as of a certain date, I shut my eyes as to everything that happened after that date. We are concerned with the data right up to that time and I don't bother to find out what the true production is. Right now I am appraising a property as of 1941. I don't like to look at the production of that property in 1942 and 1943 to guide me in appraising it.

Q. Mr. Pemberton, did the government's representatives tell you to disregard any opinion which you might have which would alter the agreed stipulation of facts, and stick squarely to the stipulation of facts in arriving at your opinion?

A. Yes, sir, they did.

(Testimony of John R. Pemberton.)

Q. And did you do that?

A. Yes, I did, of course.

Q. Mr. Pemberton, you stated an opinion as to \$4,000,000.00 as your value of the Dominguez oil properties in June, 1941, and then you referred to another sale. Did your reference to that other sale do any more than prove or disprove the accuracy of your methods of appraisal?

Mr. Mackay: I object to the question as leading. [517]

The Court: Well, I presume counsel is asking him whether or not in his opinion they coincide.

Mr. Melville: I will pose the question again, your Honor. I will withdraw that.

By Mr. Melville:

Q. Mr. Pemberton, did you compare or did you try to compare the properties that were involved in the Grubb Estate sale with the properties that are involved in this case, or, on the contrary, did you simply compare your methods of valuation as tested in the Grubb Estate by an actual sale with your methods of valuation in this case?

Mr. Mackay: The witness has already answered that.

A. Yes, that is what I did.

By Mr. Melville:

Q. Which? A. The latter supposition.

Q. You did not make any comparison, then, as I understand it, of the oil properties involved in the Grubb Estate case with the oil properties in this case? A. No, I did not.

(Testimony of John R. Pemberton.)

Q. Only your method of valuation was compared?

A. Exactly, because I had no basis for making a comparison of oil properties inasmuch as I had been served with a stipulated scale of future revenue, and that is all [518] I was concerned with.

Q. Do you think it would be fair for you as an engineer, and if you had knowledge of the oil properties involved here, such as one who works over the field every day—would it be fair, in your opinion, to interpose your own views on top of the stipulation and let those views influence your opinion?

A. No, it would not be proper.

Mr. Melville: No more questions.

Recross Examination

By Mr. Mackay:

Q. Now, Mr. Pemberton, did you give consideration to income taxes? A. No.

Q. Isn't it true that the price which an investor is willing to pay for a property is determined on the basis of future net yield after the payment of tax on income and proper provision for the return of capital?

A. I should modify my answer when I said "No" to your first question. The determination of fair market value as a part of an engineering estimated present worth value does contain an element of income taxes, yes. So, in determining a fair market value I do take into consideration income taxes.

(Testimony of John R. Pemberton.)

Q. How much did you take into consideration here? A. How much?

Q. Yes. [519]

A. How do you mean, how much?

Q. Well, we had pretty heavy taxes in 1941.

A. I did not make any computations particularly. My opinion is that, generally speaking, a reduction of a discounted present worth calculated value anywhere from 75 to 85 per cent is a good figure to use to determine a fair market value. Now, then, the amount of discount there is dependent a good deal on the rate at which the earnings are going to come back. I am a firm believer that a fair market value of a property ought to be something around what the property will turn back in about five years. I don't like the eight and ten-year pay-outs.

Q. All right, Mr. Pemberton, let us just assume that the tax rate in 1941 was 31 per cent.

A. The tax rate on whom?

Q. Well, let us assume on the corporation who may want to buy. A. On a buyer?

Q. Yes. A. Yes.

Q. So, let us assume that at the very day that was received by the buyer it had to pay 30 cents out to Uncle Sam.

A. He does not have to——

Q. Well, 30 cents on the profit.

A. Yes, he takes his depletion out and pays his 30 [520] per cent on the remainder.

(Testimony of John R. Pemberton.)

Q. Let us assume it is 30 cents at that time on every dollar less depletion. A. Yes.

Q. And that he has to pay the State of California, say, 3 per cent. Now, how much or what discount factor would you use under those circumstances to arrive at the fair value of that expected income?

A. Well, as I say, I don't know a good way to determine those things. Generally speaking, anybody that can buy this kind of a royalty and has that kind of money and is dealing in that is certainly going to be in that much of a bracket or more.

Q. Yes, or it would be more than that?

A. Yes, it is certainly going to be more than that. This schedule of stipulated receipts which was handed me shows that it will pay out \$4,000.00 in five years.

Q. \$4,000,000.00 in five years? A. Yes.

Q. Of course, that is before taxes, isn't it?

A. That is the receipts.

Q. Yes, I know, but that would be before taxes?

A. Yes, but it is going to return \$9,000,000.00, or \$5,000,000.00 more.

Q. I know, but you are taking it now for the five [521] years? A. Yes.

Q. Now, suppose that you take 30 per cent or, say, 33 per cent, and that is a rather reasonable bracket, out of that, how long will it take to get back, I mean, to get the capital back?

A. Well, of course, that could be calculated by

(Testimony of John R. Pemberton.)

taking out the depletion and finding the taxable amount——

Q. Let us take your——

Mr. Melville: Let him answer it.

By Mr. Mackay:

Q. I am sorry. I beg your pardon.

A. ——and determining what he would save in five years, of course.

Q. But you think a five-year pay-out is reasonable, don't you?

A. Yes, I think that a five-year pay-out is a good basis.

Q. And that is after taxes, of course, that you get your money back in five years? That is what you mean, don't you?

A. No, I don't mean that. No, I mean that the property itself would return that much money in five years.

Q. No matter what the tax may be?

A. Well, obviously a man who is in such a high tax [522] bracket that he could not afford to pay such an amount because he never would get his money back would not buy it, that is true. So, we will assume that there must be buyers who are in such a tax bracket that they have the money and can afford to buy the royalty on a five-year gross pay-out.

Q. All right. Now, let us just assume that we have that man who is in the 33 or 35 per cent bracket—let us make it easy—the 30 per cent bracket, for instance, and we have a stipulated

(Testimony of John R. Pemberton.)

figure here for the last seven months of 1941 of gross receipts of \$412,652.00. Now, will you please deduct 27½ per cent for depletion from that?

A. Well, he would have more than 27½ per cent depletion.

Q. All right. A. The buyer would.

Q. All right, you put that on a cost basis, then.

A. Obviously the buyer would. He would have capital depletion.

Q. All right, suppose you take 50 per cent of it.

A. He might have more than 50 per cent. In the case of the Grubbs, they had 74 cents a barrel, and on your figure it was 60 cents a barrel, so it would be probably more than 50 per cent, his depletion would be.

Q. Well, I think you made—I will withdraw it. I think you stated that in your opinion it was worth [523] \$4,000,000.00?

A. That is right.

Q. Let us assume that that is the cost. Now, let us assume——

A. How many barrels would he have bought? I would like to know that.

Q. Let us assume that a man paid \$4,000,000.00 for that, that he is in a 30 per cent bracket, and the first seven months in 1941 he receives \$412,652.00. What would be the depletion for that on cost, Mr. Pemberton?

A. Well, I don't know what it is because I don't know how many barrels the stipulation refers to.

Q. Oh, you don't know how many barrels the stipulation refers to? A. No.

(Testimony of John R. Pemberton.)

Mr. Mackay: No further cross examination.

Redirect Examination

By Mr. Melville:

Q. Mr. Pemberton, in the Grubb Estate sale, which is the one you made the comparison with—is that correct? A. Yes.

Q. ———who was the buyer?

A. Shell Oil Company.

Q. Did you suppose that the Shell Oil Company had a tax problem? [524]

A. I suppose they have.

Q. And who was the seller?

A. The seller was the Estate of Alice Grubb.

Q. And did you suppose or assume that they had a tax problem? A. I know they did.

Mr. Mackay: I will admit that everybody has got a tax problem.

The Court: We could almost take judicial notice of that.

By Mr. Melville:

Q. So that if your method of valuation was proved to be substantially correct by an actual sale between a willing buyer, the Shell Oil Company, and the Grubb Estate, a willing seller, both with tax problems, would that assume that your method—I mean, would that establish in your opinion that your method of valuation takes into account adequately the tax problem?

A. Yes, sir, I believe it does.

(Testimony of John R. Pemberton.)

Q. Did you give as much consideration to the tax problem in this case—withdraw that.

Did you use the same method of valuation in this case, the same underlying principles of valuation in this case, as you did when you testified for Mr. Mackay in the other case? [525]

A. No. They didn't have any royalty out there at all. Their situation was——

Q. Quite different?

A. Quite different.

Mr. Melville: No more questions.

Recross Examination

By Mr. Mackay:

Q. Mr. Pemberton, is it not a fact that the Shell Oil Company was also the lessee of the Grubb Estate? A. Yes.

Mr. Mackay: That is all. May we have a recess, your Honor?

The Court: Yes, we will suspend at this time for a brief recess.

Mr. Melville: The witness may be excused.

(Witness excused.)

(Short recess.)

Mr. Melville: Mr. Clute, will you take the stand?

WALKER S. CLUTE

called as a witness by and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your full name, please, for the record? [526]

The Witness: Walker S. Clute.

By Mr. Melville:

Q. Mr. Clute, what is your business or profession?

A. Consulting geologist and petroleum engineer.

Q. How long have you been engaged in that business? A. 25 or 26 years.

Q. Would you please state for the record your educational and professional qualifications?

A. I took my training at Stanford University and graduated from that university in 1915 with a degree in geology and mining. In 1915 and 1916 I was Deputy Oil Inspector of the City of Los Angeles. In 1916 and 1917 I was with Smith, Emery & Company, Chemical Engineers, in Los Angeles, and my work included the Potash Development Company in Nebraska. In 1917 I was engineer and geologist with the Petroleum Midway, California Star, and Pan-American Petroleum Companies in the Montebello field in California. In 1918 I was with the United States Army Air Corps. In 1919 and part of 1920 I was connected with Harry E. Johnson, petroleum engineer, in Los Angeles, in-

(Testimony of Walker S. Clute.)

cluding geological work in Texas and Oklahoma and New Mexico, Arizona, Wyoming and California, and including also in 1920 exploration and geology for the Granada Oil Company in Colombia, South America. In 1921 and 1922 I was Oil and Gas Valuation Engineer with the Bureau of Internal Revenue in Washington, D. C. From 1923 until 1929 I maintained [527] my own office as a consulting engineer in Los Angeles. In 1929 and 1930 I was Field Superintendent in charge of drilling and production for the Wyoming properties of the Atlantic and Pacific Oil Company.

In 1930 and 1931 I was with the United States Geological Survey in Washington, D. C., and also in 1931 head of the U. S. Geological Survey Office in Tulsa, Oklahoma, in charge of drilling and production on Indian lands. In 1932 and 1933 I was head of the Oil and Gas Section of the California State Tax Research Bureau, and since 1934 up to the present time I have maintained my own office as consulting engineer and geologist in Los Angeles with certain assistants and a staff of engineers.

Q. Have you had experience in valuing oil properties and oil royalties?

A. Yes, a large percentage of my work has been valuation work. I think I have appraised, the last estimate I made, something in the neighborhood of \$800,000,000.00 worth of producing properties and royalties, not including refineries, which would be refineries and refinery methods and which would be in addition to that.

(Testimony of Walker S. Clute.)

Q. Were you furnished the facts which have been stipulated in this case with respect to oil royalties of the Dominguez Estate Company?

A. I have been furnished with them and I have read [528] them, yes, and studied them.

Q. Did you, on the basis of those, make an appraisal with a view of formulating an opinion as to the fair market value on June 5, 1941, of the oil royalties of the Dominguez Estate Company?

A. I did make an appraisal, and I want to say first that I have read over the stipulation and I find that the stipulation includes a schedule of expected royalty revenue beginning in 1941 and extending until 1965 and thereafter in the amount in dollars of \$9,029,979.00, and it is further stipulated that the number of barrels of royalty oil to go with that is 7,992,871 barrels. Now,—

Q. You studied—were you through?

A. No, I am not, because you asked me if I had been furnished the facts. Now, these, in my understanding, are the facts on which this is to be predicated now. So, when you asked me if I have been furnished the facts, I wanted to make that clear that to my mind that is the start.

Q. Very well. I know what you have in mind, so I will bring it out. When this case was coming on for trial approximately a year ago were you retained to make an appraisal of the oil royalties of the Dominguez Estate Company?

A. Yes, I was.

(Testimony of Walker S. Clute.)

Q. And did you make that appraisal without the benefit of any stipulation? [529]

A. Surely, yes.

Q. When you were again brought into the case this year, did the government representatives tell you to forget any estimates or appraisals or facts which you formulated or relied upon a year ago, and to rely strictly upon the stipulated facts in this case in formulating your opinion?

A. Very well. They did not tell me exactly to forget it because I do not suppose a person can divorce those things in their own mind from what they have seen before, but I was instructed that here was the basis, as I say, and that we were now to move over and see what this stipulated revenue is worth and—oh, yes. So, that was agreeable to me because in looking over this stipulation here compared with what I had done before they are substantially enough in agreement so that I could comfortably accept this. Is that clear?

Q. That is clear. Now, on the basis of the stipulated facts in this case, have you formulated an opinion as to the fair market value on June 5, 1941, of the oil royalties in the Dominguez Estate Company? A. Yes.

Q. Will you please state that opinion?

A. Well, my opinion is that the value as of June 1, 1941, was \$4,450,000.00.

Q. You said June 1st; the question was June 5th. Have you formed an opinion as to the value on June 5th? [530]

(Testimony of Walker S. Clute.)

A. June 5th is what I meant. If I made an error of a few days, it is June 5th.

Q. Now, will you please tell the court how you arrived at that opinion?

A. Yes. I started with the rate of production that was laid out and stipulated to. I am perfectly aware that when you have revenue coming in the future that you should recognize the present value of that production, so I made a computation at a rate of interest to start with which is called the 10 per cent rate of interest, that is to say, a discount factor of 10 per cent, and I discounted that revenue at 10 per cent, and I see that the present worth of that revenue amounts to \$4,859,625.00. That is the mathematical calculation on the thing. Well, now, in my mind that for many—I will just say at this point that for many ordinary cases that is perfectly understandable and that is within reach of a fair market value of a property, and I have appraised properties on a figure arrived at at that point and have explained to the people who want this value that there is the value at a 10 per cent discount and that is the fair market value, but in this case I looked further, and, as royalties go, this is a big royalty, it is a very valuable royalty, and using the 10 per cent discount factor—well, it is a big royalty and in my mind taxes entered into it and so, giving it the proper study which I have laid out on a certain [531] schedule here, I reduced that by a further percentage which I thought was proper to recognize the extra tax burden on this

(Testimony of Walker S. Clute.)

thing, and that reduced my value to \$4,450,000.00.

Mr. Melville: No more questions—pardon me. Withdraw that.

By Mr. Melville:

Q. Mr. Clute, after you made your appraisal, did you then compare your appraisal methods with any other appraisals which you have made that have been proven by an actual sale?

A. Yes, I did.

Q. Would you tell the Court about that?

A. I had in mind an appraisal that I made of a certain royalty interest, and the appraisal was made for the purpose of demonstrating about what the fair market value might be for the purpose of a sale, purchase and sale. The sale was consummated and I think my appraisal was used as the basis. Anyhow, here is the way it went. I appraised the one-sixth royalty interest owned by the O'Day Estate in the Athens-Rosencranz Field as of November 1, 1944, in the amount of \$282,470.00. That appraisal was requested by the Citizens National Bank of Los Angeles.

Now, this same royalty interest was sold five months later for \$356,000.00 to the Union Oil Company and the Barnsdale Oil Company, 50/50. I will say also that they were the operators of the property before the property was offered [532] for sale to any comer, as far as I know.

In making that appraisal I used the same method that I speak of, as I used in this Dominguez Estate

(Testimony of Walker S. Clute.)

royalty here, determining for my own purposes the reserves and the future revenue to come, and then discounted that at the 10 per cent factor, and taking out county taxes, and then after county taxes that left me a present worth of \$282,470.00. Well, this property did sell five months later for \$356,000.00, and I don't know whether this is hearsay evidence or not, but the attorneys for the company said they added on another \$50,000.00 for what they considered real estate value, possible realty value to the property there that went with the royalty, and in the meantime there were some 150,000 barrels of royalty oil taken out in that five months, so that it balances up. I was somewhat short, I would say \$50,000.00—no, \$70,000.00 short of the actual selling price but I was on the low side with this method.

Q. In other words, the actual sale established, as I understand your testimony, that the method of appraisal, if anything, is conservative.

A. Yes.

Mr. Melville: No more questions.

Cross Examination

By Mr. Mackay:

Q. Now, Mr. Clute, I understand you to say that you [533] considered the 7,000,000 barrels and the probable revenue of \$9,000,000.00 and that you applied a 10 per cent discount there for interest and you arrived at a present worth of \$4,859,625.00?

A. Right.

(Testimony of Walker S. Clute.)

Q. And after that, then, you approached it from the—to get some discount because of the tax drag on the income that might come?

A. That is right, yes.

Q. Do you think that 9 per cent is a sufficient penalty to allow for the burden of taxes, federal and state?

A. 9 per cent for the burden you speak of, but am I to understand that is a 9 per cent tax on the——

Q. Gross revenue.

A. ——on the gross revenue that the buyer will sustain?

A. That is right.

A. No, the seller is going to sustain——

Q. I am talking about the buyer.

A. You want an answer to that question?

Q. Yes.

A. No, I don't think 9 per cent is enough. I think it is going to be heavier than that.

Q. On the gross?

A. No, that is not heavy enough on the gross.

Q. That is not heavy enough on the gross, is it?

A. No. In an onstensible revenue of this size it is going to be more than that, something substantial.

Q. It would be around 30 or 40 per cent, wouldn't it?

A. I don't want to—I don't think it is 30 per cent. It is 20.

Mr. Melville: Your Honor, the question in this case is the fair market value of oil royalties in

(Testimony of Walker S. Clute.)

companies which various people might have to pay. I object to the question.

Mr. Mackay: I wish we could forget taxes that way, your Honor.

The Court: This is cross examination. Objection overruled. We will allow some latitude.

By Mr. Mackay:

Q. Now, you reduced that present worth by \$409,000.00, didn't you?

A. Evidently, if that is the difference between them. I never subtracted it, but it must be.

Q. Well, can you tell us what percentage of the expected gross revenue that \$409,000.00 is? In other words, take \$409,000.00 against \$9,000,000.00—I beg your pardon—\$409,000.00 against the value you placed on it, \$4,859,000.00.

A. I don't think that is proper at all, \$409,000.00 tax—no, I mean value off of—oh, I see what you mean. A reduction of \$409,000.00 in value against the \$4,400,000.00 [535] that I spoke about, you want to know what that percentage is?

Mr. Mackay: I will withdraw that. I think that is confusing.

By Mr. Mackay:

Q. You assumed that there would be \$9,000,000.00 total revenue, didn't you?

A. Yes, I am giving that to start with, yes.

Q. And you assumed that out of that \$9,000,-

(Testimony of Walker S. Clute.)

000.00 gross revenue there would be a tax penalty of \$409,000.00, didn't you?

A. Yes, all right, \$409,000.00.

Q. What percentage is that?

A. Isn't that nearly $3\frac{1}{2}$ per cent?

Q. I would think that is about it. Do you think that is a fair penalty for taxes?

A. I had not considered it in that light, that being the tax penalty. I guess it is.

Q. Yes, that is the tax penalty.

A. Yes, but I have got the taxes worked out in another method, so the tax would be \$429,000.00 to a purchaser.

Q. Now, Mr.——

A. No, I mean \$608,000.00 tax.

Q. Now, Mr. Clute, taxes were very much on the increase around this basic date, were they not, income taxes, [536] federal income taxes?

A. Yes, I think they were.

Q. You have done a lot of work on taxes, haven't you?

A. Yes, I think they were, already.

Q. Do you know what the corporate rate was in 1941, federal?

A. Was it about $17\frac{1}{2}$ in 1941?

Q. Don't you think it was around 30?

A. Four years ago? I don't recall.

Q. Do you know that corporations had to pay a franchise tax in California?

A. Surely.

Q. Now, let us just assume that the corporation

(Testimony of Walker S. Clute.)

tax, federal, was around 30 per cent, and let us assume that there was a 3 per cent franchise tax in California. A. All right.

Q. And in 1941 you heard the President say in March that the taxes were going to be greatly increased?

A. Oh, very well, I guess that was accepted at that time, yes.

Q. You knew that the federal government had started drafting men, didn't you, and building up an Army?

A. Surely. All right.

Q. And, of course, as an engineer, you would expect that as a result of that taxes would go up, didn't you? [537]

A. That was the beginning of the war period and I think we knew that taxes were going to go like they did in the previous war, that we would have to pay the taxes. All right.

Q. And you knew, of course, that the government proposed an excess profits tax in 1941—in 1940, I mean?

A. Well, you are recalling details that I cannot answer right now.

Q. You were very familiar with the very high tax that we had in the last war? At that time you worked with the Bureau of Internal Revenue, or shortly after? A. Shortly after.

Q. And that went up to a very high tax, didn't it? A. Yes.

Q. So that on June 5, 1941, the basic date, any

(Testimony of Walker S. Clute.)

reasonable man would have expected that under the conditions prevailing then for the next four or five years the taxes would be greatly increased, isn't that a fact? A. Now——

Q. Isn't that a fact? Can you answer that?

A. Well, yes, all right. They were going to be greatly increased, all right. But I——

Q. Just a moment.

Mr. Melville: Let him explain, Mr. Mackay.

Mr. Mackay: He may have the right to explain if he [538] wants to explain. I am sorry.

A. (Continuing) You were asking me about the income taxes that are going to increase in 1941?

By Mr. Mackay:

Q. Just what you would expect them to do.

A. All right. At the same time, those are the taxes, let us understand, that are going to apply to the buyer of a property after he has taken a static sum of money and exchanged it for an income property, so that he has an income property, and these income taxes are going to apply to him, increasing or not?

Q. Yes.

A. Very well. At the same time we have got to assume that what is called the capital gain tax is going to increase the same rate, it is going to be 30 or 40 per cent.

Q. At that time it was about that much, wasn't it?

A. The seller is faced with a capital gain tax

(Testimony of Walker S. Clute.)

which may or may not be the same as the income tax. He is on the other side of the fence. So, we can argue these taxes up to 95 per cent for both sides if you want to.

Q. I don't want to do that, but you can if you want to.

A. I don't. All right, 30 per cent. We have got them both, the buyer and the seller, facing higher taxes.

Q. That is right. [539]

A. What they are at any date, is that right?

Q. That is right.

A. The capital gain tax ought to almost offset an income tax for the other fellow if they make the rates the same. We know that they don't. The capital gain tax is lower usually due to the time element that he has held the property, and so forth, but you have got your taxes pretty equally balanced there.

Now, then, when we make valuations and I use a straight 10 per cent discount, while that will apply to properties where they can—where taxes are moderate, that will include, in my mind, taxes up to about 12½ per cent, either corporation or individual, whichever you want, on a buyer and a seller. When I give you a value at a 10 per cent figure I think that that value includes any consideration of taxes that may be borne by the buyer or the seller, capital gain on one side and income on the other, and I have brought you to the trading point

(Testimony of Walker S. Clute.)

where the buyer and seller will take a position according to each one's tax status.

Q. Mr. Clute, did you make a determination here as to fair market value——

Mr. Melville: Just a minute. Are you through, Mr. Clute?

The Witness: Yes, all right.

Mr. Mackay: He has had plenty of time. [540]

Mr. Melville: Were you through?

The Witness: No. I wanted to finish my answer.

Mr. Mackay: I don't want to hear his story. I think he has answered the question, your Honor.

The Court: You may proceed with the cross examination. Will you complete your question, Mr. Mackay? The reporter will read it.

(Question read.)

By Mr. Mackay:

Q. ——of the income to be expected in the future as stated in this——

A. Yes.

Q. So you were trying to put a value on future income, were you not? A. That is right.

Q. So, if you are approaching that from a sensible standpoint, as a very fine engineer, you would have to take into consideration the future expected taxes, wouldn't you?

A. Yes, that is what this schedule is for.

Q. O. K. Now, let us assume that the taxes of a corporation that may buy that or may have bought that at that particular time—at the time of the

(Testimony of Walker S. Clute.)

purchase let us assume that the taxes were 30 per cent federal, and let us assume that there was a 3 per cent franchise tax in California——

A. Might I change those? [541]

Q. Can't I ask my question first? Or do you want to talk some more?

The Court: Proceed with your question, and the witness will refrain from answering until it is completed.

Mr. Mackay: Please read my question.

(The question referred to was read.)

By Mr. Mackay:

Q. ——and, furthermore, that the corporate taxes were greatly increased because of the impending war, and even the suggestion by the President was that the taxes would not be less during the next four or five years than, say, 30 per cent federal and 3 per cent state, now will you please tell the court how much, in your opinion, you should penalize that future expected income by those taxes?

A. I will try to. I was going to interpose something a moment ago to say that if you would let me change those rates to 4 per cent state tax and 20 per cent federal tax I could give you some pretty close figures.

Q. Is that what you used?

A. In a computation, illustrative for my own purposes.

Q. You used that to determine the proper

(Testimony of Walker S. Clute.)

amount you should reduce it to get this \$409,000.00 for your present worth value?

A. I will tell you why I did not want to use 4 per cent and 20 per cent nor your 3 per cent and 30 per cent, because [542] if you get your taxes up that high then your stipulation is not worth anything. You have stipulated that this price of oil shall be such and such, \$1.14. If you are going to assume that taxes are going up, you have got to assume that the prices are going up too and your stipulation is gone.

Q. You don't like the stipulation?

A. What?

Q. You don't like the stipulation?

A. You did not stipulate taxes, did you?

The Court: You are arguing, both of you, gentlemen. Let us ask the question and then proceed.

The Witness: Very well.

Mr. Mackay: Will you please read that question again?

(Question read.)

A. No.

By Mr. Mackay:

Q. Well, are you able to tell the court what you would penalize the future estimated income in arriving at the fair market value on account of the tax burden that that income would have to bear?

A. Yes. I assumed that the buyer of this prop-

(Testimony of Walker S. Clute.)

erty, faced with 4 and 20 per cent taxes, and remembering that he gets depletion on cost, would be subject to about \$1,167,782.00 of state and federal taxes, and that would result—— [543]

Q. Give me that figure again, please.

A. \$1,167,782.00, and when you work the present worth of the remaining revenue after that, the value then would be \$4,132,000.00 for the property, using 4 and 20 per cent.

Q. Now, do I understand——

A. But I don't think it is proper to use that when we use that price of oil.

Q. Do I understand, Mr. Clute, that if a buyer paid \$4,450,000.00 for these oil royalties his taxes that you have used there would amount to \$1,167,782.00? A. Yes.

Q. In other words, the \$1,167,782.00 would not go in his pocket but would go to the tax authorities? A. That is right.

Q. That is right? A. That is right.

Q. Now, if you subtract that from \$4,450,000.00, what would be your answer?

A. You will have to subtract the present worth.

Q. Can't you subtract what I am asking you to subtract or do you need a comptometer?

The Court: Let us proceed with the examination of the witness.

A. I have got something subtracted. I have got to [544] take that \$1,167,000.00 away from \$4,859,000.00, and that leaves \$3,691,000.00, but you understand that I do not say that that is your tax penalty

(Testimony of Walker S. Clute.)

because you should take the present worth of \$1,167,00.00, which I presume would be about \$600,000.00, away from the \$4,859,000.00. Shouldn't you? Your taxes are only paid out by years, and it is like a cost, so you take the present worth of that cost.

The Court: Any further cross examination of the witness?

Mr. Mackay: Yes, your Honor.

By Mr. Mackay:

Q. Now, Mr. Clute, what do you allow that 10 per cent for—what is that 10 per cent discount which you allowed there before you took off the taxes?

A. That is a discount factor which in my opinion includes for ordinary properties a fair return of interest on your investment plus nominal taxes, and by nominal taxes I will specify up to about 12½ per cent, because this runs along through the years in times when taxes are up to about 12½ per cent, state and federal together, and whether it is corporation or individual, about 12½. All right. If I use the 10 per cent factor, that is taking care of taxes up to about 12½ per cent. Then if I want to assume that taxes will be 4 and 10, the state 4 and federal 10 more, which amounts to about 13 per cent more, then I have got [545] 12½ and 13, and I have got about 20 per cent taxes, and I feel that is about all that a business or property can work under, and if I should allow any higher rates

(Testimony of Walker S. Clute.)

of taxes than that I cannot do it with an oil property producing this revenue, so I have allowed all the taxes I can in this first 10 per cent plus 4 and 10 per cent more.

Q. Where do the hazards come in there?

A. Your hazards have been mostly—there is a little business hazard in your 10 per cent but it has mostly been taken out in the estimate of oil.

Q. Tell us, Mr. Clute, what goes in the 10 per cent?

A. Just a reasonable interest return, and that will give a value that is so sufficiently close to the fair market value that it can very well absorb taxes, buyer's and seller's taxes.

Q. All right. How much do you allow for interest?

A. What? Oh. You are going to split that 10 per cent up.

Q. I want you to split it up.

A. I can't split it up any closer than that. I just have a feeling it includes the two.

Q. What kind of hazards go into that, Mr. Clute?

A. I will say not the hazards of production because I have taken those out when I have made my estimate.

Q. What estimate? [546]

A. The oil reserves and future production.

Q. I know, but this is already made for you. You started out with the estimated oil reserves.

A. All right, then there is no hazard—you asked

(Testimony of Walker S. Clute.)

what hazards were in it. There is no more hazard in this 10 per cent that I can put my finger on.

Q. You mean there is no hazard in the 10 per cent?

A. I will give up at that point. I don't know how much hazard there is in there. Nobody knows.

Q. What do you allow for the use of money in that 10 per cent? A. For use of money?

Q. Yes. A. You are thinking now of——

Q. Don't you understand what I asked you?

A. For use of money? I think you mean the money that I am going to have returned to me for reinvestment.

Q. Oh, no, Mr. Clute.

A. Well—for use of money? Oh, I understand now what you mean? Borrowed money? What interest I would have to pay on borrowed money? Is that what you mean?

Q. What part of the 10 per cent represents interest, if any, for the use of money?

A. Oh, I see. I don't know.

Q. You don't know? [547]

A. No, I don't.

Q. You have not given that any thought? Well, what part represents taxes?

A. In my mind about—I think if I went to work on that problem I would probably assume that about 4 per cent represented taxes and 6 per cent the money interest.

Q. Do you mean to tell me there is no hazard

(Testimony of Walker S. Clute.)

in getting that income? Don't you understand what I mean?

A. Yes, of course I do. I have to think that over.

Q. I don't want to rush you, I am sure. You can't answer that question, can you, Mr. Witness?

A. I can't answer it very well.

Q. Do you mean to tell the Court here that a buyer would be willing to risk his money in this kind of a purchase on a 6 per cent return—to get his money back plus 6 per cent? Is that what you mean? That must be so.

A. No. No, I don't.

Q. You think a man would want a little more return? A. Yes, I do.

Q. Why did you say a moment ago that you thought 6 per cent would be the interest?

A. You say, would he buy this property here? Well, sir, I think he would buy another property. We value virtually none of them at 10 per cent and we place——

Q. Where do you—— [548]

A. Remember, that is a long life property.

Q. Anyway, you don't mean to tell the court that a person would be willing to put their money in here and just get back 6 per cent interest plus their capital, do you?

A. I think he would want more.

Q. Yes. How much more?

A. Well, he would certainly want the full 10 per cent if he could.

(Testimony of Walker S. Clute.)

Q. Just for his interest alone?

A. Yes, I believe so.

Q. But you have figured it on the theory that a man would be satisfied to get his money back plus 6 per cent, haven't you?

A. Yes. So, now, you have got the whole 10 per cent taken up with the use of money. Now, where are the taxes?

Q. Now you think the interest alone ought to be 10 per cent, don't you?

A. Yes, I do think that way.

Q. Now, a man would have to get his money and pay his taxes too, wouldn't he? What?

A. Get his money back and pay his taxes too, yes.

Q. Where is he going to get the money to pay his taxes if you merely discount it 10 per cent?

The Court: Do you understand the question, Mr. Witness? [549]

The Witness: Yes, I do.

A. Naturally, I only allowed the 13.6 more per cent of taxes, that is, 13.6 per cent——

By Mr. Mackay:

Q. That is not enough to allow on the income that will have a tax penalty of 30 per cent or more, Mr. Clute? A. Well, that is——

Q. Can you answer yes or no?

A. I am not going to answer yes or no because this property is going on for the next 20 years, and do we know the tax rates are going to be 30 per cent for all the life of this property? It might not be

(Testimony of Walker S. Clute.)

at all. It may be in 1941, 1942, and up until 1948, but they are going to change. They were going up at that time, but in the foreseeable future they are going to be pretty high but maybe not 30 per cent, so I don't think your assumption is entirely correct.

Q. Well, do you think a willing buyer would take a chance on June 5, 1941, of the taxes going down?

A. Oh, not going down below that point, no. Of course not.

Q. As a matter of fact, you know that most people who were capable and willing to buy anything like this were pretty well scared of the national debt at that time, were they not?

A. Probably so. [550]

Q. And there could not be much hope——

A. Remember also they hoped for an additional price of oil, whether they got it or not. That was ahead of him just as taxes were.

Q. Yes. Now, if you allow only 6 per cent, if you allow 10 per cent there in your discount for interest and you do not allow enough for the man's taxes, how do you figure the prospective buyer will ever get any profit out of it, Mr. Clute?

A. It is clear on the arithmetic of it that he could not.

Q. He could not get any profit on it. could he?

A. No.

Mr. Mackay: That is all.

(Testimony of Walker S. Clute.)

Redirect Examination

By Mr. Melville:

Q. Mr. Clute, do you consider yourself an expert on taxes?

A. I have been told that I am not.

Q. Do you consider that taxes are a charge against income or a charge against fair market value?

A. They are a charge against income, but when you write them into a valuation they are like any other cost of which you may ascertain the present worth, and then the present worth is a charge against value. [551]

Q. Mr. Clute, you have clients, don't you?

A. Yes.

Q. If you were willing to perform a specific service for a client in a given year, let us take 1941, to do a certain job for a certain client in 1941 for, let us say, \$5,000.00, then along came 1942 and the taxes had gone up, doubled, would you charge less to do that same job in 1942 than you did in 1941, taking into consideration the tax problem?

A. No, naturally no.

Q. Would you charge more?

A. If I were entitled to it, depending on my contact with my client. In a commercial way I would be inclined to charge more, yes.

Q. Would you consider that your services were entitled to a certain value and your tax problem was your own business?

(Testimony of Walker S. Clute.)

A. Yes. I have got to fall back on my relations with the client there, but if I were in business absolutely buying and selling for a measurable time I would just have to charge more when my taxes went up. They are a cost against my income.

Q. You would have to charge more for your services because the taxes were higher than you would have to charge for your service if the taxes were lower? A. Yes. [552]

Q. Now, if you were selling something rather than your services, selling a commodity like oil, and you had a tax problem where your taxes were greater, you are the prospective seller, if you make any gain on the sale of this oil property now you are going to have to pay higher taxes, would there in your opinion be any reason for selling it lower because the taxes were higher?

A. No, it would have to sell for a higher price.

Q. That is, from the seller's standpoint?

A. From the seller's standpoint. Did you mean if I was selling oil or a property as a lump sum so the capital gain takes hold?

Q. Yes.

A. I would want a higher price then to cover my taxes.

Q. All right, then, if the very same willing buyer that Mr. Mackay has been talking about takes all the discounts for taxes and the very same willing seller adds a lot of things because of taxes, would they ever get together and consummate a sale, in your opinion, unless they both disregarded taxes?

(Testimony of Walker S. Clute.)

A. They would go farther apart, yes, one would go one way and one the other.

Q. Unless they disregarded taxes they would not ever get together, would they? Mr. Clute, let us assume that a given stock, let us take Chesapeake & Ohio—sells on the [553] New York Stock Exchange today for 58 and there are any number of sales in it, 1,000 or 2,000 or 10,000, does that in your opinion establish the fair market value of that stock? A. On the Exchange? Yes, indeed.

Q. All right. Now, suppose that a charwoman, who is in the very lowest income tax bracket, sold 100 shares today of C & O at 58 and that that particular 100 shares was bought by J. Pierpont Morgan, who is probably in the highest tax bracket, does the fact that Mr. Morgan would have a tremendous tax problem to concern himself with and the charwoman had practically none, change the fact that \$58.00 is the fair market price of that stock?

A. Obviously no. There are a million other shares which set that value for some reason or other between them.

Q. Now, Mr. Clute, you followed in making your valuation in this case a method that you have followed on the basis of your years of experience?

A. Right.

Q. Is that the same method that you followed in valuing the—what was that sale?

A. The O'Day.

Q. —the O'Day property?

A. Yes.

(Testimony of Walker S. Clute.)

Q. Who was the buyer in that case?

A. The Union Oil Company and Barnesdale Oil Company [554] together.

Q. They were the buyers? A. Right.

Q. Were they also the lessees?

A. Yes, they were.

Q. They were, then, well acquainted with the property? A. Yes, indeed.

Q. Is it a safe assumption that they had a tax problem? A. Of course.

Q. Who was the seller?

A. The O'Day Estate, administered by the Citizens National Bank.

Q. And the Estate, you presumed, had a tax problem? A. I do, yes.

Q. Did you take into consideration taxes just as much, no more and no less, in that appraisal in the O'Day Estate case as you did in this case?

Mr. Mackay: If your Honor please, I object.

The Court: A lot of this is already in the record, so if you are not cross examining your witness I am reluctant to stop you.

Mr. Melville: I will withdraw the question.

The Court: Very well.

By Mr. Melville:

Q. What was the date of that O'Day sale? What year? [555] A. May 3, 1945.

Q. Were the taxes in 1945 more than they were in 1941?

(Testimony of Walker S. Clute.)

Mr. Mackay: Well, if your Honor please, I suppose we all know that.

A. Yes, I think they were; yes, I do.

By Mr. Melville:

Q. Now, did you take into consideration your method of appraisal in the O'Day case the tax problem of the oil companies that bought it or the O'Day Estate that was selling it?

Mr. Mackay: If your Honor please, I object to that. It is not really proper on redirect. It has been gone into and I think it is beyond the pale of redirect examination.

The Court: Probably, but we will permit him to answer this question. You may answer.

The Witness: Please read it again.

(Question read.)

A. I gave consideration to taxes and just concluded that whatever taxes that might be applicable to it—there might have been a balance between one side and the other but they were encompassed within that 10 per cent factor that I used.

By Mr. Melville:

Q. And was the subsequent sale—did the subsequent sale of that property in your opinion confirm the accuracy of your method of valuation? [556]

Mr. Mackay: I object to that, if your Honor please. It is not proper redirect.

The Court: Overruled. I think he has already answered that.

(Testimony of Walker S. Clute.)

Mr. Mackay: Several times, your Honor, I think.

The Court: Do you recollect the question, Mr. Clute?

By Mr. Melville:

Q. You may answer it, Mr. Clute.

A. In my opinion it confirmed the accuracy of my appraisal.

Mr. Melville: No more questions.

Mr. Mackay: That is all, Mr. Clute.

(Witness excused.)

The Court: We will suspend for a brief recess.

(Short recess.)

Mr. Melville: Mr. Corby, will you please take the stand?

GRANT W. CORBY,

called as a witness by and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your name for the record, please?

The Witness: Grant W. Corby.

By Mr. Melville:

Q. Mr. Corby, will you please state your educational background?

(Testimony of Grant W. Corby.)

A. I graduated from Stanford in 1922, took a Master's Degree in 1923.

Q. What subject? What course?

A. Geology and mining and valuation.

Q. And have you had experience in the oil business? A. Yes, I have.

Q. How much? A. Well, since 1923.

Q. And what have you been doing in the oil business since 1923?

A. Well, I have been doing field geology exploration, geology valuation, purchasing royalties, consulting work, consulting engineering.

Q. Have you been furnished with the stipulated figures on probable future royalties from the developed oil reserves of the Dominguez Estate Company after June 5, 1941? A. I have.

Q. Are these the exhibits that you were shown?

A. (After examining). They are.

Q. Have you formed an opinion, based upon those exhibits and figures, as to the value of the royalty assets of [558] the Dominguez Estate Company as of June 5, 1941? A. Yes, I have.

Q. What is that opinion?

A. My opinion is \$4,330,255.00.

Q. Will you please explain how you arrived at that?

A. Yes. It was a short method that I used and it consisted of taking the total production according to the figures you supplied to me and cutting the value in half, and in addition to that I worked out the return, using a 10 per cent interest rate,

(Testimony of Grant W. Corby.)

and worked out a pay-out, and it paid out in around 17 years.

Q. And what figure did you take 50 per cent of?

A. \$8,660,511.00, which was the figure supplied on this stipulated sheet.

Q. And what exhibit is that on?

A. That is on Exhibit 2 here.

Q. Read the whole thing.

A. Joint Exhibit 2-K (2).

Q. Will you read it again? A. Is that 11?

Q. That is 11.

A. I am sorry. It is Joint Exhibit 11-K (2).

Q. Is that method of valuation one that is recognized in the oil industry? A. Yes, it is. [559]

Q. Is it the method on which oil royalties are bought and sold? A. Yes, it is.

Mr. Melville: You may cross examine.

Cross Examination

By Mr. Mackay:

Q. Did I understand you to say that you took the total estimated production and divided it by half? A. Yes.

The Witness: Is that an estimated production that you supplied me on those figures?

By Mr. Mackay:

Q. Isn't it? Did you read the stipulation?

A. Yes, I read the stipulation.

Q. Will you please refer to the stipulation—where is it?

(Testimony of Grant W. Corby.)

The Court: Here is the original stipulation, if you wish it, Mr. Mackay (handing).

Mr. Mackay: Thank you.

By Mr. Mackay:

Q. I call your attention to the stipulation, paragraph (k) on page 5:

“Joint Exhibit 11-K (1) is the estimated amount, in barrels of oil, of ultimate probable future production from known oil reserves of all oil properties owned [560] by Dominguez Estate Company on June 5, 1941, together with the royalty share of Dominguez Estate Company therein. The estimated probable future production by calendar years is based upon the assumption that all wells being produced on June 5, 1941, would continue to be produced to the full indicated capacity of the formation to yield the oil, and, further, that each probable productive location of said known oil reserves would be developed and produced to its full indicated capacity in accord with its probable development program.” [561]

You understand that, don't you?

A. I understand it.

Q. That that is merely an estimate?

A. That is an estimate, yes.

Q. With respect to the second paragraph, it reads just about the same with respect to the rate

(Testimony of Grant W. Corby.)

of production? You understand that to be merely an estimate, don't you? A. I do, yes.

Q. So, you took the estimated total barrels and you divided it by half? A. That is right.

Q. And then what did you do?

A. Used that as the present day value.

Q. Did you use that as the present——

Mr. Melville: I didn't hear that question. Did you say "barrels" or "dollars"?

Mr. Mackay: I said "barrels". He said "half." I was just going to clear that up.

The Witness: This is in dollars.

By Mr. Mackay:

Q. I beg your pardon?

A. I have never seen any records of barrels. I have seen dollars.

Q. You have not seen any records of barrels at all? So, then, you have taken the estimated gross receipts, [562] A. That is right.

Q. And you divided those in half?

A. That is right.

Q. And is that your fair market value?

A. That is the market value that I arrived at, yes.

Q. What did you allow for income taxes?

A. The other 50 per cent.

Q. The other 50 per cent? A. Yes.

Q. What profit is there in there for a purchaser, then, Mr. Corby?

A. Well, there is profit in there, according to

(Testimony of Grant W. Corby.)

my valuation, by deducting your total income—cutting it in half, there is enough profit there to pay your taxes and a return on your money and also investment on your principal.

Q. How much?

A. I worked this—I took these figures here of \$4,330,225.00, and worked out a pay-out in years and deducted 10 per cent from that, from each year's pay-out, and returned the rest back to capital, and that worked out to be a 16½ or 17-year pay-out.

Q. So, you just assumed that a person would be willing to put his money in that and get a 10 per cent return, is that right?

A. Yes, gross.

Q. Gross? What would be the net income?

A. Will you please state your question a little more clearly? You mean a 10 per cent net return?

Q. What do you mean?

A. You are asking the questions.

Q. O.K. What went into that 10 per cent? Why did you use 10 per cent?

A. I think that 10 per cent should take care of taxes and interest.

Q. Nothing else?

A. No, because already you have got a 50 per cent deduction.

Q. I though you said you reduced it 50 per cent because of taxes?

A. To bring it to present day value because of interest and taxes, and I took the pay-out each month and took 10 per cent of that and returned

(Testimony of Grant W. Corby.)

the balance to principal. On that basis it worked out to be a 16½-year pay-out, practically 17 years.

Q. What profit did you figure in there?

A. The profits in your 10 per cent.

Q. So, all the profits would be in the 10 per cent?

A. Where else would it be?

Q. I am asking you.

A. I put it in the 10 per cent. [564]

Q. That is what I mean. You put all the profit in the 10 per cent? A. That is right.

Q. So, it is your opinion that a willing buyer would be willing to invest his money and to have received a profit of 10 per cent, is that right?

A. I think so, yes.

Q. I beg pardon? A. Yes.

Q. Well, how about taxes, then?

A. What do you mean, how about taxes?

Q. Well, the man has to get that 10 per cent back, at least, and he would have to pay taxes, wouldn't he? A. It depends on the purchaser.

Q. Who in America does not have to pay taxes, Mr. Corby?

A. It depends on a number of things. If it is a corporation, one corporation might buy these royalties that is in the hole.

Q. In the hole? A. Yes.

Q. Wouldn't they have to pay taxes?

A. Not if they were in the hole, if they had a deficit.

Q. You mean to say that a corporation having a deficit——

(Testimony of Grant W. Corby.)

A. If they bought these royalties and threw them into [565] their source of income it would be worth more to them than it would be to John D. Rockefeller.

Q. Let us assume you found a willing buyer who was operating in a deficit and that he purchased that for your estimated fair market value of \$4,330,000.00; now, is it your opinion that that purchaser could get all of that money back without paying any taxes, including the 10 per cent profit?

A. It depends on the circumstances of the purchaser. You say he is in debt.

Q. You said he was in debt. I didn't.

The Court: You are arguing, gentlemen. Let us proceed with the question and answer form, please.

By Mr. Mackay:

Q. Do you think that a corporation with a big deficit like that could pay \$4,330,000.00?

A. Yes, I think one with a deficit could pay it and make money on it. That is my opinion.

Q. But it is still your opinion that a willing purchaser, able to buy, would be willing to put his money—to put down \$4,330,000.00 and get his capital back in 17 years and 10 per cent interest, is that right? A. Yes.

Q. Is that right? A. That is right. [566]

Q. And without any allowance for hazards?

A. You have got an allowance for hazards right there.

(Testimony of Grant W. Corby.)

Q. Mr. Corby, are you familiar with the earthquake hazard in California? A. Yes.

Q. Do you know, as a matter of fact, that the Havens-Wright wells, which are not very far from these—that many of those were completely severed and made non-useful because of an earthquake? You know that, don't you?

A. I have heard it.

Q. You heard it? A. Yes.

Q. You also have known that in Santa Fe Springs, which is just a little bit east of there, in the same general territory, that the same condition happened, don't you?

A. Yes, I believe the production was altered in some of the wells.

Q. Don't you think a willing purchaser might take into consideration the earthquake hazard?

A. Yes, I think so, and I think also a willing purchaser would take into consideration the possibilities of the deeper sands too, which we have not talked about here.

Q. At Dominguez? A. Yes, in 1941.

Q. Have you ever been on the property?

A. Yes.

Q. When? [567]

A. Well I was across the property a few months ago.

Q. When? A. April.

Q. April? A. Yes.

Q. Which property did you go on?

(Testimony of Grant W. Corby.)

A. I simply went across the Dominguez field.

Q. In an automobile? A. Yes.

Q. You did not stop? A. No.

Q. And you saw all the working conditions and are able to pass an opinion on them?

A. Well, I was not asked to pass an opinion on those working conditions, and I have not been asked here.

Q. Did you make any inquiry here as to the average daily production of these wells?

A. I did not.

Q. Wouldn't you consider that that information would be important in determining the fair market value?

Mr. Melville: If your Honor please, I don't want to curtail the cross examination, but it seems to me that after we have spent weeks, and in fact months, agreeing upon stipulated facts in order that we could avoid calling witnesses who would have to go into the oil reserves and all these [568] other factors, it seems unfair for counsel to ask this witness if he did not consider facts which were not in the stipulation. In view of the fact that the witness has stated he considered all the factors necessary to formulate an opinion, if he is qualified to formulate an opinion and has all the factors necessary, he is entitled to express it. If counsel did not think he was qualified he should have objected at the time.

Mr. Mackay: If your Honor please, I think the

(Testimony of Grant W. Corby.)

witness is the one that brought the deeper zones in here.

The Court: I think I will sustain the objection as not proper cross examination. You may proceed.

By Mr. Mackay:

Q. But you have made no examination of the property, have you?

Mr. Melville: When?

Mr. Mackay: At any time.

The Witness: Yes.

By Mr. Mackay:

Q. When?

A. In the early stages of the—just about the time of the discovery well in the Dominguez field.

Q. That was about 1923, wasn't it?

A. Yes.

Q. But not since that time?

A. Geological examinations? [569]

Q. Yes. A. Yes.

Q. When?

A. When I was employed by the Marland Oil Company, we were attempting to get a lease up there.

Q. When was that?

A. It was about the time the Union—you will have to supply that date. I don't know.

Q. Do you know how many zones there are in that field? A. About eight.

(Testimony of Grant W. Corby.)

Q. Do you know the depths of the deepest wells?

Mr. Melville: I object, your Honor. That is not material to the issue in this case.

Mr. Mackay: If your Honor please——

The Court: He may answer the question. Objection overruled.

The Witness: I can't remember the depth of the deepest. I think they are around 8000 or 9000, but I do not know that entire section has not been penetrated.

By Mr. Mackay:

Q. How do you know that, Mr. Corby?

A. There has been no well, according to my knowledge, that has ever cored the schist.

The Court: I didn't get that. What did he say?

(The answer was read.) [570]

The Court: That is an expression that is not in my vocabulary.

The Witness: May I explain it?

The Court: Yes. It is not in my vocabulary.

The Witness: The schist has been recognized as the basement rocks in the Los Angeles Basin in which there is no production. As an example, in the Venice field immediately above the schist there is a productive zone and below that is considered not to be productive. It is what we call the basement rocks.

The Court: You express the whole thing in three words, "core the schist"?

The Witness: Schist or basement rocks.

(Testimony of Grant W. Corby.)

The Court: That is a new word, a new expression.

By Mr. Mackay:

Q. Don't you know, as a matter of fact, that Well No. 79, drilled in 1940, pierced that zone, went below the schist?

A. I don't know definitely that it did, no. I think there has been some discussion on that geologically.

Q. Is it not a fact that Well No. 135 on the Reyes lease was drilled into the schist?

A. Not to my knowledge.

Mr. Melville: What date?

Mr. Mackay: That is all, your Honor.

The Court: Any redirect? [571]

Mr. Melville: No questions.

The Court: Let me ask the witness—counsel, you may wish to clear it up. I notice he used the figure of \$8,666,000.00, which does not include the estimated income after 1965, is that correct, the basic calculation?

Mr. Melville: That is correct.

The Court: Do you know why he did that, either of you?

Mr. Melville: Well, I think I can explain it as a lawyer but not as an engineer.

The Court: I don't wish to interfere with your trial of the case. It is just a query that occurred to me, that is all. You can do as you please about clearing it up.

(Testimony of Grant W. Corby.)

Mr. Melville: Your Honor, when it comes to dealing with oil in the ground, there is nobody that can say positively how much oil is in any given well. It is just impossible. God alone knows.

Mr. Mackay: I will stipulate that.

Mr. Melville: Now, then, the engineers make various appraisals, and we had various appraisals in this case, the Government's appraisals that there was so much oil down there, and the taxpayer's. Is this on the record?

The Court: It may be if you desire.

Mr. Mackay: I think it ought to be.

Mr. Melville: I will be glad to leave it on the record. [572]

The Court: So far it has been.

Mr. Melville: If you disagree with anything I say you can stop me.

Mr. Mackay: I don't believe I can disagree with you, Colonel.

Mr. Melville: Thank you. The Government said in appraisals what they thought the oil reserves were, and the taxpayer likewise had appraisals, and we realized that this law suit might take weeks or months if we each had to bring in engineers who appraised these oil properties and each engineer would have to state his valuation as to the oil reserves. Probably each engineer would have a different estimate of the rate of production and probably each engineer would have a different estimate of the future price of oil. So, if each side had five engineers, a total of ten, and each one had

(Testimony of Grant W. Corby.)

a different opinion, we would have a total of one thousand possible answers from which your Honor would have to choose the right one. So, in asking the hypothetical questions of our witnesses on the valuation it was conceivable that each side would have to ask one thousand hypothetical questions in order to cover all possibilities. Therefore, recognizing our problem and your Honor's problem, we got together and compromised, the Government came down and the taxpayer came up, and we agreed on so many barrels in the ground. This eliminated any engineering testimony as to how much oil was in reserve. [573]

We also agreed on the probable future rate of production and thus we eliminated any necessity for engineering or geological testimony as to that factor. We also agreed on the third, and only conditional, factor, in order to arrive at the future royalty income, namely, the future price of oil.

Having agreed on all those, we reduced our agreements to a stipulation of probable future royalty income.

Mr. Mackay: Estimated.

Mr. Melville: Estimated. Now, the word "estimated," your Honor, was used because we recognized, as I previously stated, that God alone knows what the answer is as to how much oil there is down there, so we did not want to state it as a fact. It would be a presumption on the Almighty for us to state, as a fact; how much oil is in the ground, we don't know, but that is the best estimate

(Testimony of Grant W. Corby.)

that we could make. It amounts to a compromise on the side of both the Government and the taxpayer, and when we came into Court—and I am speaking now for myself and I hope Mr. Mackay agrees with me—when we came into Court we thought the figures were agreed upon. If they are not agreed upon, I don't know why we spent the time working out the stipulations.

The Court: Well, I have nothing but the kindest feeling for counsel on both sides for having gotten so nearly together. I don't want you to misunderstand anything I might have said. I merely asked why the witness did not use the [574] \$9,000,000.00 figure, which Mr. Paine and some of the other witnesses had used, instead of the \$8,666,000.00.

Mr. Melville: Well, I am frank to let the witness answer that, but I think that the Government is willing to recognize that the amount of oil that is left in the ground after 1965 can be charged off to a safety factor.

The Court: Very well. Is that all from this witness, gentlemen?

Mr. Mackay: Yes. I merely want to say that the stipulation speaks for itself.

(Witness excused.)

Mr. Melville: Your Honor, in order to clarify three of the exhibits, 1-A, 2-B and 3-C——

The Court: Let us have them, if you will, please.

(The papers were handed to the Court.)

The Court: You may proceed, Mr. Melville.

Mr. Melville: It is hereby stipulated and agreed between the parties that as to Joint Exhibits 1-A, 2-B, and 3-C, that the aggregate liability stipulated to in said exhibits include 5/12ths of the Federal Income in California Franchise Taxes, and the property taxes for the full year 1941, which were a lien not yet payable.

The Court: Well, see if I understand what you are stating there correctly. You have under the column of book value listed current liabilities of \$239,000.00 odd, and then [575] you have listed the same current liabilities under the stipulated fair market value, that \$292,000.00 odd. So, what you mean to say, if I am correct—I am only asking—is that the \$292,000.00 odd does include the 5/12ths of the taxes. Is that what that amounts to?

Mr. Melville: Are you referring to the figures, your Honor, under fair market value?

The Court: Yes, in Joint Exhibit No. 1, stipulated for fair market value.

Mr. Melville: What it amounts to, your Honor, is that, that the particular corporations that we are dealing with in this case—I believe this correct, Mr. Arnold—are on the cash receipts and disbursement basis.

Mr. Arnold: That is correct.

Mr. Melville: And Mr. Arnold asked the Government if we would agree to let him include the income taxes for the entire year 1941 when we were stipulating as to the figures as of May 31, 1941. Now, it so happens that the figures that are in the stipulation do not agree with the Revenue Agent's

reports and the Government's data. In order to reconcile the two, we wanted to stipulate that as to real state taxes the taxes for the entire year are in there, although the stipulation is only supposed to go as far as May 31, 1941, and that the Federal Income Taxes are in there to the extent of 5/12ths of the year, which is correct. The justification [576] for putting the entire 1941 real estate taxes in, your Honor, is because under California law they become a lien on the property prior to May 31, 1941.

The Court: Very well. Thank you, gentlemen. Off the record.

(Discussion off the record.)

The Court: On the record. We will suspend in the trial of the Caldwell and the Cotton cases until 9:30 tomorrow morning.

(Whereupon, at 5:05 p. m., a recess was taken until 9:30 a. m., Friday, October 12, 1945.)

PROCEEDINGS

October 12, 1945—9:30 a. m.

The Clerk: Docket No. 2257, Victoria L. Cotton, and 7583, Virginia Caldwell.

Mr. Melville: Your Honor, one of the first things I would like to do this morning is to clear up the two points with respect to the proceedings yesterday. The first is that I would like the record to

show that Mr. Webb, who appeared here rather reluctantly, did so under subpoena. Will you so stipulate, Mr. Mackay?

Mr. Mackay: I will accept your word. Would he be available for a little further questioning?

The Court: Off the record.

(Discussion off the record.)

Mr. Melville: Will you stipulate that Mr. Webb appeared here under subpoena?

Mr. Mackay: I will take your word for it.

Mr. Melville: Will you take a look at the official subpoena and admit it or shall I have to put it in evidence?

Mr. Mackay: Surely, I will stipulate it, Colonel.

Mr. Melville: The other point I would like to clear up with respect to Mr. Webb's testimony, your Honor, is that at the time I was unable to find attached to the stipulation any facts with respect to previous production in barrels. I thought at the time that there was evidence to that effect in, but I could not find it, so I stated on the record that [582] apparently it was not in. I find, however, that I was wrong then and that in fact Petitioner's Exhibit 23 gives the royalty barrels by leases by years for the Dominguez Estate Company.

Mr. Mackay: I knew that all the time. Is it possible to get Mr. Webb back?

Mr. Melville: Off the record, please.

The Court: Off the record.

(Discussion off the record.)

The Court: Then the answer to counsel's question is that Mr. Webb will not at this time be available for further cross examination?

Mr. Melville: That is my best, honest belief, your Honor.

The Court: Very well. Off the record.

(Discussion off the record.)

The Court: On the record.

Mr. Melville: Your Honor, I have in my hand the minute book of the Dominguez Estate Company which contains the minutes of a regular meeting of the board of directors dated August 13, 1941, and I offer at this time to read into the record a short paragraph from those minutes setting forth the views of the chairman, Mr. H. H. Cotton, with respect to how to arrive at the value of the Dominguez Estate Company's stock. Any objection?

Mr. Mackay: If your Honor please, I object to that [583] as incompetent, irrelevant and immaterial. I will admit for the purpose of the record that that is the minute book which counsel now has in his hand, but certainly, if your Honor please, what may have been said in the minutes of the Dominguez Estate Company can have no bearing on this case here. We are now valuing the stock of Virginia Caldwell and Victoria Cotton that they gave away and it has no place here and it is incompetent, irrelevant and immaterial. I say that I admit it is the minute book of the company, but I see no purpose at all and I think it is entirely

incompetent and irrelevant for the purpose offered.

Mr. Melville: I will admit, your Honor, that I have not laid a very good foundation for my offer, but I was trying to spare Mr. Cotton, an elderly gentleman, from taking the stand.

Mr. Mackay: I will admit it is the minutes.

Mr. Melville: If I have to lay a real foundation——

The Court: I think I am prepared to rule. We will receive it. If it has no materiality we will ignore it. What are you doing? You are reading only a portion of it?

Mr. Mackay: That is right.

The Court: Does counsel for the Petitioner desire that it all be in evidence?

Mr. Mackay: No, not so far as that one is concerned. Go ahead. [582]

The Court: Well, we will hear the excerpt. It may be read into the record.

Mr. Melville: Your Honor, before I start reading, I would like to clear up the matter of it being an excerpt. At this meeting they did certain things and I am reading everything with respect to the subject matter that is contained in this paragraph. I am not reading the part of the minutes that said who was present and that they read the minutes of the previous meeting, and that they voted dividends, and so forth, but everything relating to the subject matter of this paragraph is being read, your Honor:

“The chairman, Mr. H. H. Cotton, then brought up the matter of an appraisal on the

Dominguez Estate Company stock, stating that in his opinion he felt that an appraisal of the assets should be made of the Dominguez Estate Company to determine the present value of its stock. After a short discussion, a motion was made by Mr. Edward A. Carson, seconded by Mr. David V. Carson, and unanimously carried, authorizing the officers to select suitable appraisers to make this appraisal."

Your Honor, I have in my hands a copy of the report to the stockholders of the Dominguez Estate Company, dated March 25, 1941, rendered by H. H. Cotton, the president, and I offer in evidence the entire report. [585]

Mr. Mackay: I think I have a copy of it here.

Mr. Melville: Do you have two copies?

Mr. Mackay: That is all I have but we may be able to get another.

Mr. Melville: In addition to the copy that is attached to the minutes of the stockholders' meeting, Mr. Mackay has very kindly given me an extra copy of the report to the stockholders referred to. I offer it in evidence with the request that I be permitted to withdraw it and make a certified copy for my own use and return the original to the Clerk.

The Court: If there is no objection, the document may be handed to the Clerk and marked Respondent's Exhibit BB, and it will be received in evidence. Leave will be given to withdraw it for the purpose of making copies.

(The report referred to was marked and re-

ceived in evidence as Respondent's Exhibit BB.)

[Respondent's Exhibit BB set out in full in Book of Exhibits.]

Mr. Melville: Your Honor, I have in my possession the minute book of the Dominguez Estate Company, containing the minutes of the stockholders' meeting held on April 10, 1940, attached to which is a report to the stockholders, dated March 28, 1940, rendered by H. H. Cotton, president, and there are three excerpts from that which I would like to read, although I have no objection if the entire report goes in.

Mr. Mackay: I am sorry. I have not seen it.

The Court: We may be off the record for a moment. [586]

(Discussion off the record.)

The Court: Are you ready to proceed, gentlemen?

Mr. Melville: I am, your Honor.

Mr. Mackay: If your Honor please, we should like to object to this. This is a report to stockholders in 1940, and it would seem to me it would have no bearing upon the issue here. It could not have any bearing upon the values, and we object to it for that reason. Besides, if your Honor please, it is a statement by the officers of the company, it is true, but what value does it have to go back there in 1940 when we had conditions—until, if your Honor please, they show the conditions in 1940 they

have not laid the proper foundation. If they are trying to make a comparison of conditions in 1940 and 1941 by these minutes or by these inferences or whatever they are trying to put in, they must first under the rules of law lay a sufficient foundation so they compare like things and not apples with peanuts, and until that foundation is laid, if your Honor please, I think it is entirely incompetent, irrelevant, and immaterial.

The Court: What is your theory as to the materiality of competency of this particular evidence, Mr. Melville?

Mr. Melville: Simply this, your Honor, when Mr. Cotton rendered a report to the stockholders in 1940 he made this statement——

The Court: Now, without reading, just tell me what [587] is your theory as to the competency of the evidence. How is it going to connect with the valuation that we have a year or so later?

Mr. Melville: My theory is, your Honor, and I am prepared to prove it the hard way if necessary, that the directors, stockholders and officers of this company had constantly over a period of years from 1936 to 1941, inclusive, placed a value of \$1000.00 a share on Dominguez Estate Company stock, and I can prove it if I can get in this minute, that is, I can make one step toward that proof.

The Court: Well, you have hardly answered the question. You are valuing, or we are attempting to value, in this case the stock of this company as of June 5, 1941. Now, as to a value placed upon the stock by officers of the corporation at some earlier

date, it would probably be hearsay and be mere speculation or opinion of the officers. They may have been entirely too optimistic or they may have been entirely too pessimistic. I fail to see where it has a great deal of materiality, assuming that there is any competency at all, although I am reluctant to exclude it from evidence if you think there is some real connection that can be made.

Mr. Melville: Your Honor, I am prepared to show that there have been sales of this stock, not to outside interests but among themselves, in the family group, of the stocks involved in this case, not a great many perhaps, not [588] more than 16 or 17 sales, over a period of several years, but those sales will establish that the value placed on this stock by the people themselves in round dollars of one thousand a share. Now, I appreciate that if I take any one sale and try to put it in evidence my opposition will object on the ground that it is an isolated sale, and I must admit that it would be an isolated sale, but when you take them altogether and they represent all of the sales for a five-year period preceding our basic date, it seems to me it is material.

Mr. Mackay: May I make an observation, your Honor? In 1941, the evidence shows, the Dow Jones averages were 118. I think it will show also that back in 1936 they were something like 196. Conditions were entirely different. Until counsel is prepared to show conditions exactly the same at both dates, it does seem to me that it is going far afield on the question of valuation. We must not overlook

the fact too that according to the stipulations since 1936 we have shown the revenue, a tremendous amount of revenue, it is true, but it has been coming from the oil pool down there, and every barrel of oil that comes out lessens that. So, why take a lot of time to prove what happened in the earlier stages until he lays a foundations that conditions were the same in 1941 as in 1936? It seems to me it would be entirely incompetent.

Mr. Melville: Mr. Cotton, will you please take the witness stand?

HENRY HAMILTON COTTON

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your full name for the record, please.

The Witness: Henry Hamilton Cotton.

By Mr. Nelville:

Q. Mr. Cotton, what relation are you to Victoria L. Cotton? A. Husband.

Q. What is your position, if any, with the Dominguez Estate Company?

A. President of the company.

Q. Are you on the board of directors?

A. I am.

Q. What position? A. Director.

Q. Are you chairman of the board?

(Testimony of Henry Hamilton Cotton.)

A. No, I am president of the company. I don't know whether that would follow or not.

Q. Who is chairman of the board?

A. I don't know that we have any.

Q. The board of directors?

A. Well, if there is any, I am the chairman, but I am not referred to as that. [590]

Q. Are you a stockholder in the Dominguez Estate Company?

A. In a very small capacity. I own two shares.

Q. Is your wife a stockholder? A. No.

Q. Was your wife a stockholder in 1941?

A. I don't believe so.

The Witness: Will you give me the record on that, Mr. Arnold?

A. (Continued) I think she sold her stock in about 1938 or 1939.

Q. Whom did she sell it to?

A. Her daughters.

Q. For how much money?

A. She sold it for the same price that it was charged to her in the account, taking neither gain nor loss, and I think it was approximately \$1000.00 a share.

Q. I show you a document and ask you if you recognize any of the signatures on it.

A. (After examining) I recognize that signatures, I recognize this and I recognize that (indicating.)

Q. Will you state whose signatures they are?

A. This is my wife's, this, is the tax accountant

(Testimony of Henry Hamilton Cotton.)

that prepared the return, and this is the Notary Public who acknowledged the signatures. [591]

Q. What return is this?

A. This is the income tax return for the year 1939. It is dated here.

Q. By whom?

A. By Victoria L. Cotton, I imagine. (After examining) Yes.

Q. In that return was there reported the sale of any shares of stock of the Dominguez Estate Company?

A. It looks like there was here.

Q. How many shares? A. 99.

Q. And what was the amount realized?

A. \$99,000.00.

Q. Was there also reported on that same return the sales of any Francis Land Company stock?

A. It looks like .03—some very fractional share.

Q. .03267, is that correct?

A. That is what it says, for which she got \$32.67.

Q. And was there also reported a larger sale of Francis Land stock? A. Yes, 33 shares.

Q. What was the——

A. \$33,000.00. You realize, Mr. Melville——

Q. Answer the questions, Mr. Cotton. [592]

Mr. Mackay: He may explain.

The Witness: No, I won't try to explain. What is the use? I just want to say that the sale was set up at the price it cost her because——

(Testimony of Henry Hamilton Cotton.)

Mr. Melville: I think that is proper cross examination, your Honor?

The Court: Well, we will let the answer stand.

The Witness: It does not mean anything, I guess, anyway.

Mr. Melville: Your Honor, may I have the privilege of cross examining this witness on the ground that he is not a friendly witness?

The Court: He has not so shown himself to be as yet.

By Mr. Melville:

Q. Mr. Cotton, in making the report to the stockholders in 1940, did you make a statement in which you referred to the value of the Dominguez Estate Company stock?

A. Could I see that report?

(The document was handed to the witness.)

A. (Continued) (After examining) Yes, sir.

By Mr. Melville:

A. (Reading):

“In the unsettled condition of world and national affairs and the many problems that confront your company from day to day, we feel the ability to pay a return of 7.7 per cent on the basis of \$1000.00 per share of our stock is one thing that helps maintain the stability and value of this stock at somewhere near its appraised value.”

(Testimony of Henry Hamilton Cotton.)

Q. Thank you. Would you mind reading the first paragraph of that report, Mr. Cotton?

The Court: Are you asking the witness to read it into the record? Is that the purport of your question?

Mr. Mackay: If your Honor please, I think if any part of that report goes in the whole thing should go in.

Mr. Melville: I have no objection.

The Court: Well, why don't you agree upon what you wish?

Mr. Melville: I offer in evidence the entire report to the stockholders dated March 28, 1940.

The Court: It may be handed to the Clerk and marked for identification as Respondent's Exhibit CC. What mechanics will you use to make it available to us, gentlemen? Do you expect to submit a copy or what?

Mr. Mackay: We will get a copy.

Mr. Melville: Off the record.

(Discussion off the record.)

The Court: What shall we show on the record at [594] this juncture, gentlemen, that you are now proposing to offer as Respondent's CC a compared copy of the minutes of the corporation as of some date in 1940? Is that what you are going to do?

Mr. Melville: Yes, your Honor, March 28, 1940.

Mr. Mackay: Is that a report to stockholders?

Mr. Melville: Yes.

Mr. Mackay: It is a report to stockholders?

(Testimony of Henry Hamilton Cotton.)

Mr. Melville: Report to stockholders of Dominguez Estate Company, dated March 28, 1940.

The Court: We will assign you a number that may be used then, namely, Respondent's Exhibit CC, and when the compared copy is available it may be presented to us informally for filing.

(The report referred to was marked and received in evidence as Respondent's Exhibit CC.)

[Respondent's Exhibit CC, set out in full in Book of Exhibits.]

Mr. Mackay: If your Honor please, to clear up the record, it is a report dated March 28, 1940, for the year 1939.

Mr. Melville: It will speak for itself.

Mr. Mackay: Each year's report covers the previous year, not the future year.

The Court: This is a rather awkward way to proceed, gentlemen. You have here voluminous books, and unless you want to introduce all of the books in evidence and take them back to Washington, then you should agree upon some method of making [595] available to use the pages that you want in evidence. If you wish to do that by compared copies or by photostatic copies, of course, you may do so. I think we will suspend at this time for a brief recess for the specific purpose of allowing counsel an opportunity to go over the books briefly and see just what you propose to offer in evidence.

Mr. Melville: Your Honor, I stayed down——

(Testimony of Henry Hamilton Cotton.)

The Court: And then we can get along with the receipt in evidence of these documents or wait until we do get copies available.

Mr. Melville: That is an excellent suggestion, your Honor, but I would like the record to show that I did stay down and went over these books last night with Mr. Bennion, Mr. Mackay's associate.

The Court: That is all right. We need not worry about that. Would 10 or 15 minutes help you gentlemen get straightened out, Mr. Mackay and Mr. Melville?

Mr. Mackay: I think so.

The Court: To see just what you want in evidence? Very well, we will take a brief recess.

(A short recess was taken.)

By Mr. Melville:

Q. Mr. Cotton, did the Dominguez Estate Company—

The Court: May I ask you this, you made an offer of the entire report? [596]

Mr. Melville: That is now already in evidence.

The Court: It has not been received. If that is what you wish, the document may be handed to the Clerk and marked for identification as Respondent's Exhibit DD. That seems to be the report you are referring to.

Mr. Melville: It is my understanding that I now have in evidence the report to stockholders dated in the spring of 1941.

(Testimony of Henry Hamilton Cotton.)

The Court: Is this the same report that we have heretofore marked as Respondent's Exhibit BB?

Mr. Melville: No, your Honor.

The Court: Well, I am ruling that DD is not in evidence. You may make an offer. Let us complete the offer and either receive the document or reject it. CC is what you said would be furnished by a compared copy.

Mr. Melville: Off the record.

(Discussion off the record.)

Mr. Melville: Your Honor, I have gotten in as CC the report dated in 1940. When I started to talk about a paragraph of the report that was rendered in 1939 you suggested that I get together with counsel, and it is the paragraph with respect to the 1939 report that I am now going to offer in evidence, and I am starting to ask questions and lay the ground work for that.

The Court: You have already offered it. I don't mean to be arbitrary, but I am trying to keep my record straight. Now, you just got through a moment ago saying, "We offer this in evidence." Off the record.

(Discussion off the record.)

The Court: You may proceed, Mr. Melville. We will see if we can get straightened out.

Mr. Melville: I think I can straighten it out in a moment, your Honor.

The Court: Very well. You may proceed.

(Testimony of Henry Hamilton Cotton.)

Mr. Melville: I had three reports to stockholders that I have been talking about. I got one in evidence marked——

The Court: Respondent's BB.

Mr. Melville: And the next one I got in evidence marked Respondent's CC.

The Court: That was a copy of the minutes which I said you would furnish?

Mr. Melville: That is correct. Now, I have laid that book aside and I have in my hands the report to stockholders in 1939.

The Court: Very well. Then, so we will be straight, suppose you hand the Clerk at this time the document that you propose to offer as an exhibit and she may mark it for identification as Respondent's DD for identification.

Mr. Mackay: Now I am confused. I thought the report for 1939 was the last report that went in. Now I understand counsel is offering another report for 1939. [598]

Mr. Melville: Now, your Honor, the report was dated in 1940 and covered the year 1939. Now, this report is dated in 1939 and covers the year 1938.

The Court: Hand it to the Clerk and we will mark it.

Mr. Mackay: If your Honor, please, just a moment, I want to object to that as incompetent, irrelevant and immaterial.

The Court: You cannot object to it being marked for identification.

(Testimony of Henry Hamilton Cotton.)

Mr. Mackay: I am sorry: You are quite right, your Honor.

The Court: We will mark it for identification.

(The report referred to was marked as Respondent's Exhibit DD for identification.)

By Mr. Melville:

Q. Mr. Cotton, I ask you whether or not the Dominguez Estate Company ever changed its capital structure in order to provide a means whereby it could purchase its stock from its stockholders.

A. Yes, sir. [599]

Q. Would you read from your report which has been marked for identification as Respondent's Exhibit DD, the paragraph wherein you told your stockholders regarding the plan?

Mr. Mackay: I will let you read it into the record yourself if you want to read it.

Mr. Melville: Thank you.

The Court: Let me see if I understand what you are doing. You had a document marked for identification as Respondent's Exhibit DD. Am I correct in understanding that you do not propose to offer the document which has been marked as DD in evidence, but that you now propose under an agreement with opposing counsel to read in evidence one or more excerpts from that particular document? Is that what you are doing?

(Testimony of Henry Hamilton Cotton.)

Mr. Melville: That is my plan, your Honor.

The Court: Very well. Is there objection?

Mr. Melville: I believe he has stated he has no objection.

The Court: Do you wish to be off the record now, gentlemen?

Mr. Melville: Yes.

The Court: You may be.

(Discussion off the record.)

Mr. Melville: Mr. Mackay is correct. The report to stockholders is attached to the minutes of the annual meeting of the stockholders, dated April 14, 1937, and the paragraph that [600] I propose to read refers to what happened in 1936.

Mr. Mackay: Now, if your Honor please, I admit that that is a minute book and that paragraph is contained therein, but I object on the ground it is incompetent, irrelevant, and immaterial to any issue involved in this case. It is too remote. It has nothing to do with values in any sense of the term, and I object to it.

Mr. Melville: Your Honor, this might be considered in the nature of rebuttal. During the presentation of Petitioner's case he had experts who were applying all sorts of discounts because this stock was in a closely held corporation. If I can show that the corporation itself arranged its corporate structure so that it could buy from its stockholders their stock so that they would not have to

(Testimony of Henry Hamilton Cotton.)

sell it to the outside public, I think it is very pertinent and material to the issues in this case.

Mr. Mackay: If your Honor please, that hasn't anything to do with fair market value.

The Court: You gentlemen make it difficult for me to rule. Now, we have gone through the formality here of marking a document as an exhibit, and I assumed that you gentlemen expected to offer the exhibit in evidence. If you do, I will hear you as to any objections as to the receipt in evidence of the exhibit. Now, without my having examined the exhibit or having any conception of what is in it, and with you telling [601] me you think the whole matter is incompetent and irrelevant, I don't know whether it is or not because I don't know what is in it. What do you propose to do?

Mr. Melville: We reached the point, your Honor, where Mr. Cotton was about to read it, and Mr. Mackay said I could read it, he had no objection.

Mr. Mackay: Wait a minute. You were talking in your opening statement about the year 1939.

Mr. Melville: But it seems to me, your Honor,—

Mr. Mackay: I would like to call—

The Court: One at a time.

Mr. Mackay: I don't mind showing this to your Honor so you can understand what we are objecting to. It is quite proper, I think, to show the Judge the paragraph that they want in (handing).

Mr. Melville: If, your Honor, the corporation changed its corporate structure in 1937 so as to buy

(Testimony of Henry Hamilton Cotton.)

the stock of its stockholders, and that would be admissible according to Mr. Mackay's own statement on the record that I could read it into the record, then certainly if the corporate structure was changed farther back in 1936, it is even more important.

Mr. Mackay: Mr. Mackay has the privilege of objecting. He objects to any year prior to 1941.

Mr. Melville: I will go back to the question and answer form. [602]

By Mr. Melville:

Q. Mr. Cotton, did you ever make a—did the Dominguez Estate Company ever change its corporate structure in any year so that it was possible to buy the stock from the stockholders?

A. Yes.

Q. What year was that? A. 1936.

Q. Did you refer to that date in any report that you made to your stockholders?

A. In 1937 it was put in the report. Of course, the stockholders all knew it because they were a party to it.

Q. Will you please read into the record the paragraph which you put in your report to the stockholders wherein you told them about this change in corporate structure and the purpose for the change?

Mr. Mackay: I will reserve a motion to strike.

The Witness: Well, with all these objections and one thing and another, am I supposed to read it.?

The Court: Answer the question.

(Testimony of Henry Hamilton Cotton.)

By Mr. Melville:

Q. There has been no objection.

The Witness: Any objection, Mr. Mackay?

Mr. Mackay: Go ahead and read it.

The Witness: (Reading): [603]

“In May 1936 the company arranged to reduce its stated capital”—they had a stated capital of \$1,000,000.00—“to a sum not in excess of \$500,000.00 to create a surplus that could be used for the purchase of stock from stockholders of the Dominguez Estate Company who wished to dispose of their holdings. Prior to this time the company was not in a position, on account of its capital stock, to do this and, inasmuch as it was a closed corporation, there was no way for anybody to dispose of their stock except at a tremendous sacrifice. Under the present conditions stocks can be retained for members of the family and not get into outside hands by sales at depreciated values.”

Of course, I—I should not elaborate, I guess. The \$500,000.00 would not be very much stock.

Mr. Melville: Your Honor, in order to conserve the Court's time and the time of my expert witnesses, I am going to turn this witness over to the opposition for cross examination at this time, but I wish the witness to remain available so we can go through these books step by step at a later time in order to present the full picture.

(Testimony of Henry Hamilton Cotton.)

Mr. Mackay: If your Honor please, I would prefer, if it is agreeable with your Honor, to cross examine this witness when all his testimony is in.

The Court: Very well. For the record let me see [604] if I understand now what has happened to Exhibit DD. There has been no formal offer of that particular document, but the excerpt which was read into the record a moment ago came from Exhibit DD, is that correct?

Mr. Melville: That is correct, your Honor.

Mr. Mackay: Right.

The Court: Very well. Mr. Cotton, you may stand aside and counsel for the Government will wish to call you later.

The Witness: I thought he wanted to cross examine.

The Court: Mr. Mackay desires to defer the cross examination until you have completed your direct.

The Witness: Oh, I didn't know.

(Witness temporarily excused.)

Mr. Melville: Mr. Arnold, will you please take the stand?

HUGH G. ARNOLD

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

(Testimony of Hugh G. Arnold.)

Direct Examination

The Clerk: Your full name, please?

The Witness: Hugh G. Arnold.

By Mr. Meville:

Q. What is your business, Mr. Arnold? [605]

A. I am a certified public accountant.

Mr. Melville: I hand the clerk a document which I asked to be marked for identification.

The Court: The clerk may mark it for identification as Respondent's Exhibit EE.

(The document referred to was marked as Respondent's Exhibit EE, for identification.)

By Mr. Melville:

Q. I hand you a document which has been marked Respondent's Exhibit EE and ask you if you recognize it?

A. (After examining) Yes, I do.

Q. What is it?

A. It is a gift tax return.

Q. Of whom? A. Lucille W. Martin.

Q. Does it bear your signature?

A. Yes.

Q. What year does it cover?

A. The year 1936.

Q. Does it contain a statement with respect to how you arrived at the value therein reported as--withdraw that question.

Does that return report the gift of any Dominquez Estate Company *tax*?

A. 15 shares. [606]

(Testimony of Hugh C. Arnold.)

Q. At what value? A. \$15,000.00?

Q. Does it report the gift of any shares of Francis Land Company stock?

A. Five shares.

Q. At what value? A. \$5,500.00.

Q. Does that return contain any statement as to how you arrived at those values?

A. Yes, it does.

Q. Will you please read it?

A. (Reading): "Values of shares in Dominique Estate and Francis Land Company taken from sales between September 29, 1936, and the date of the gift. Other values taken from actual sales on the date of the gift and/or New York Stock Exchange quotations on that date."

Mr. Melville: I offer the document in evidence as Respondent's Exhibit EE.

Mr. Mackay: Just a moment. If your Honor please, I object to this. It appears to be the return for 1936 of Lucille W. Martin, and I think it is entirely incompetent, irrelevant, and immaterial, and has no place here. It goes back to 1936. If your Honor please, if the Respondent is attempting to prove by this that this has any bearing, he must first show, as I understand, under the rules of law, that the conditions in [607] 1936 were the same as they were in 1941, which he has not done. He has not laid a sufficient foundation to justify the receipt of this document.

Mr. Melville: I believe, your Honor, that the value placed upon the stock by the stockholders

(Testimony of Hugh G. Arnold.)

themselves has a very direct bearing upon the price at which that stock will sell in an exchange between a willing buyer and a willing seller, and that this establishes not only one value placed upon the stock by one stockholder, but it is just the beginning of a long line of them that I am going to present. I cannot present them all at once.

Mr. Mackay: If your Honor please, do I understand counsel to say that just because Lucille Martin at that particular time in 1936, six years before the year we have involved, thought what she may have thought, has any material bearing upon this case or any relevancy? It is purely hearsay, and, if your Honor please, it is not proper. It just has no place in evidence.

Mr. Melville: Mr. Arnold prepared the return and what he stated on there with respect to sales is not hearsay.

Mr. Mackay: Mr. Arnold is not qualified as a witness to prove values.

The Court: The objection will be sustained.

By Mr. Melville:

Q. Mr. Arnold, do you have in court the books of Elsie [608] Rasmussen?

A. I believe they are here.

Mr. Mackay: If your Honor please, may I move to strike out what he read from this return on the same ground that I made my objection?

The Court: Well, I don't see where it is proper evidence. It seems to me it is hearsay. We will not

(Testimony of Hugh G. Arnold.)

sustain the motion to strike this, but it will not be considered.

By Mr. Melville:

Q. Do you have in court, Mr. Arnold, the books of Elsie Rasmussen?

A. I believe they are here, yes.

Q. Will you produce them, please?

A. (Producing).

Q. Will you examine those books and tell the Court whether or not Elsie Rasmussen made a sale of Dominguez Estate Company stock in 1941?

Mr. Mackay: Now, if your Honor please, I have tried a lot of cases and I have never heard of the books of someone not a party to it being introduced in evidence. That is purely hearsay and I object to the evidence.

Mr. Melville: Your Honor, if we were trying to prove the value of the stock of American Telephone & Telegraph Company and someone that is familiar with the market would testify that as of yesterday or today American Telephone & Telegraph was [609] sold by "X" individual to another unknown individual, that would seem to me to establish or tend to establish the fair market value of that stock, and that is what I am trying to prove here. One of the stockholders sold it to somebody else at a given value.

Mr. Mackay: The books of accounts kept by someone else do not prove a sale. It is pure hearsay.

The Court: The objection will be sustained.

Mr. Melville: Your Honor, I would like to state

(Testimony of Hugh G. Arnold.)

at this time that Respondent intends to subpoena Elsie Rasmussen, Victoria L. Cotton, Joseph N. Carson, and John F. Watson.

Mr. Mackay: I may say, your Honor, that I have no objection.

Mr. Melville: I will get around the hearsay.

Mr. Mackay: I am not objecting to the books of Victoria Cotton. She is a party to the suit. My objection goes to these others.

Mr. Melville: The books would still be hearsay, I presume.

Mr. Mackay: No, I will admit they are the correct books.

Mr. Melville: I will excuse the witness.

The Court: We have nothing to rule on. We are just talking. If you desire subpoenae issued, you may present your request. [610]

Mr. Mackay: There is no cross-examination.

The Court: You may stand aside.

(Witness excused.)

Mr. Melville: May we have a brief recess, your Honor?

The Court: Yes, we will suspend for a brief recess.

(A short recess.)

Mr. Melville: Your Honor, in view of the statement I made here last night about having one more witness on stock valuation who was not present, that prompts me to state for the record that that

witness was not under subpoena and he found it inconvenient or impossible to be present today. I will call my first witness on stock evaluation, Mr. Phillips.

RALPH E. PHILLIPS,

called as a witness for and on behalf of the respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your full name for the record?

The Witness: Ralph E. Phillips.

By Mr. Melville:

Q. Mr. Phillips, what is your business?

A. I am a general partner of the brokerage and investment firm of Dean, Witter & Company.

Q. Here in Los Angeles? [611]

A. Yes, sir.

Q. Are you here under subpoena?

A. Yes, sir.

Q. Are you testifying reluctantly?

A. Yes, sir.

Q. What is your educational background?

A. I have been in the securities business for more than 20 years. Prior to that time, University of California and the Babson Statistical Institute. I am a graduate of those institutions.

Q. During that time have you had experience in valuing stocks?

(Testimony of Ralph E. Phillips.)

A. Yes, sir, that is one of our requirements in our general course of business.

Q. Have you also had experience in valuing the stocks of oil royalty companies?

A. Yes, sir. We have had that problem on a number of occasions.

Q. Have you had experience in valuing oil royalties themselves?

A. My firm does not deal in oil royalties as such. We have on several occasions bought the stocks of companies which had substantial income from oil, and in at least one occasion practically all of the income of a certain corporation whose shares we underwrote and distributed to our customers, was [612] derived from oil.

Q. And you understand the ways, the recognized means and ways, of valuing oil royalties?

A. I would say that as a member of a firm engaged in the distribution of securities, we do not consider ourselves to be experts on all such problems. It has always been our practice to employ recognized experts to assist us in those valuations, and in those situations, where the income of a corporation under consideration came substantially from oil, we invariably employed recognized experts to assist us. So, to the extent that their methods are known to us, I can say, yes, we have a general familiarity with those processes and practices.

Q. Now, then, Mr. Phillips, have you been pre-

(Testimony of Ralph E. Phillips.)

sented with the stipulation of facts and exhibits in this case? A. I have.

Q. And have you studied them?

A. I did.

Q. Were you asked to form an opinion as to the value of the stock of the Dominguez Estate Company? A. Yes, sir.

Q. Did you form such an opinion?

A. I did.

Q. Please state what it is.

Mr. Mackay: I object. The witness is not qualified. [613]

The Court: As of what date?

Mr. Melville: I am sorry, your Honor.

By Mr. Melville:

Q. Did you study the stipulation of facts and the exhibits to a view to forming an opinion as to the fair market value of the stock of the Dominguez Estate Company as of June 5, 1941?

Mr. Mackay: I object to that on the ground that sufficient foundation has not been laid for the question, and also on the ground that the witness is not qualified.

The Court: Overruled.

Mr. Mackay: Exception.

The Court: Yes, sir.

By Mr. Melville:

Q. What is your opinion?

A. I should like permission of the Court to read this report.

(Testimony of Ralph E. Phillips.)

Mr. Mackay: I object to that, if your Honor please.

The Court: I don't know what report you are referring to, Mr. Witness. What is it?

By Mr. Melville:

Q. You have notes there of your method of valuation that you would like to refer to in presenting your testimony?

A. Yes. Perhaps I should not have referred to it as a report. [614]

The Court: You mean your own notes?

The Witness: My own notes, a memorandum, and work papers.

The Court: Very well, you may refer to them.

The Witness: I have been asked to compute an estimate of the proper value for the stock of the Dominguez Estate Company. I also referred here to Francis Land, but since that is not a direct question I shall delay that for a moment with your permission.

By Mr. Melville:

Q. With the Court's kind permission, I will also ask you, then, Mr. Phillips, if you were also asked on the basis of the same stipulation of facts and exhibits to formulate an opinion as to the fair market value of Francis Land Company stock as of June 5, 1941? A. Yes, sir.

Q. And were you also asked—and did you formulate such an opinion? A. Yes, sir.

(Testimony of Ralph E. Phillips.)

Q. Were you also asked to formulate an opinion, based upon the same stipulation of facts and exhibits, as to the fair market value of the stock of Carson Estate Company as of June 5, 1941?

A. Yes, sir.

Q. Did you formulate such an opinion? [615]

A. Yes, sir.

Q. Will you please explain to the Court what your opinion is as to the fair market value of the Dominguez Estate Company stock, Francis Land Company, and Carson Estate Company as of June 5, 1941, and how you arrived at those values?

A. Yes, sir.

Mr. Mackay: I object to it on the same ground.

The Court: Objection overruled.

Mr. Mackay: Note an exception.

The Witness: Reading from my notes:

“I have been asked to compute an estimate of the proper value for the stock of the Dominguez Estate Company, Francis Land Company, and the Carson Estate Company, as of June 5, 1941. In making this estimate it has been necessary to proceed on certain assumptions.

“1. That the fair market value of assets of the company other than oil royalty interest has been agreed upon by stipulation between the parties and, therefore, no verification or appraisal of these figures has been attempted by me. In attempting to determine the value of these assets, which consist of current assets, stocks and bonds, ranch real estate, and other real estate, less current liabilities,

(Testimony of Ralph E. Phillips.)

it has seemed appropriate to use as a yardstick an arbitrary discount of 25 per cent of the stated net figure, inasmuch as as of this date it was [616] possible to purchase the shares of fixed type investment companies having non-leverage capital structure at a discount of approximately 25 per cent from their liquidated value.

"2. I have assumed that the probable future oil royalty receipts for the Dominguez Estate Company after June 5, 1941, will be in accordance with the figures stipulated between the parties for the period beginning June 1, 1941, and ending December 31, 1965. No value has been given to any balance of oil royalty receipts which may become available after December 31, 1965. In arriving at a present worth figure for these probable oil royalty receipts, I have applied a formula which involves the application of a tax deduction factor based upon State of California Franchise Tax and Federal Corporation taxes at rates existent as of June 5, 1941. This formula has also taken into account statutory depletion allowances of $27\frac{1}{2}$ per cent. To the figures thus obtained for each of the years under review, I have applied a present worth discount factor calculated at 5 per cent compound interest computed annually. The resultant figure I consider to be the present value of probable oil royalties. The total present worth computation has been divided by the number of shares of the Dominguez Estate Company outstanding as of June 5, 1941. To this per share figure I have applied [617] a further

(Testimony of Ralph E. Phillips.)

discount of 8 per cent, which represents the approximate profit margin which, as a dealer in securities, I would expect to earn upon resale of these shares to customers of my firm. This profit would be apportioned to distribution costs and the risk return on the capital involved."

The detail of this computation I have worked out in accordance with that general formula method. The stipulated fair market values are as follows: Dominguez Estate Company, Current Assets, \$869.-889.84; Stocks and Bonds, \$1,141,269.74; Ranch Real Estate, \$1,629,950.00; Other Real Estate, \$1,-631,266.69; Total, \$5,272,376.27, which represents a balance, less Current Liabilities, of \$292,677.09, of \$4,979,699.18.

I have applied in accordance with my formula——

Mr. Mackay: Not so fast. I can hardly follow you.

The Witness: Would you like a copy of this?

By Mr. Melville:

Q. Slow down a little bit, if you please.

The Court: Perhaps it may not be necessary to read all of these figures into the record, inasmuch as most of them appear in the stipulations, do they not, Mr. Melville? The figures he is reading are figures which appear in Joint Exhibit 1-A, Joint Exhibit 2-B, or Joint Exhibit 3-C? Where he is just reading from those figures, I think you may as well not have them in the record. [618]

Mr. Melville: I am perfectly willing, the witness

(Testimony of Ralph E. Phillips.)

having expressed his opinion, to let the computation that he is reading go into the record. Would you like that, Mr. Mackay?

Mr. Mackay: I don't like any of it.

Mr. Melville: I think it would be better if he read it through slowly.

The Court: I was just trying to avoid reading into the record a lot of figures because I won't read them anyway when I get to reading this if they are the same as in the exhibit. If those are the figures, there is not much point in reading them into the record.

Mr. Melville: But there is more than one way to handle a set of figures, your Honor.

The Court: I don't want to interfere. Proceed. You may proceed whatever way you deem best.

The Witness: To the balance of \$4,979,699.18, I have applied a discount in accordance with my formula as explained earlier of 25 per cent, which is \$1,244,924.79, leaving a balance of \$3,734,774.39 as the figure to be divided by the number of shares outstanding, which gives a resultant figure of \$355.00 per share for assets other than oil royalties of the Dominguez Estate Company.

Now, for the oil royalty ownership, the stipulated future gross income to be received prior to January 1, 1965, is [619] \$8,660,511.00. Now, in accordance with the formula, I have taken a tax factor which figures to be 19.82 per cent of the gross royalty income, and that was explained earlier, and I can explain the detail of that if it is required.

(Testimony of Ralph E. Phillips.)

That amounts to a tax reduction of \$1,716,512.00, leaving a figure of probable net income from oil royalties after taxes of \$6,943,999.00.

“To this figure has been applied a discount of 5 per cent compound interest to adjust to present worth. This results in an average valuation for the period under review of 0.710598 per cent, or a total present worth value for probable oil royalty receipts after taxes and depletion adjustment of \$4,934,391.00.

“Dominguez Estate Co.

“Present Worth Probable Oil

Royalties	\$4,934,391.00
Divided by 10,499 shares outstanding	470.00 per share
Value per share of Assets other than oil	355.00
Value per share of Oil Royalty Interests	470.00
<hr/>	
Combined	\$ 825.00
Less—Discount of 8% to represent selling costs and profit to dealer	66.00
<hr/>	
Value Dominguez Estate Co.....	\$ 759.00 per share

“Francis Land Co.

“This company owns miscellaneous assets having a stipulated value consisting of:

(Testimony of Ralph E. Phillips.)

“Current Assets	\$10,919.59
Stocks and Bonds.....	21,630.00
Real Estate	50,672.31
Total	<u>\$83,221.90</u>
Current Liabilities are stated to be.....	<u>\$85,331.44</u>

“The resultant red figure of \$2,109.44, based on the 5,000 shares of stock of the company outstanding creates a red figure of .42 per share. This figure has been disregarded in these calculations. In addition, the company owns 5,499 shares of the Dominguez Estate Co., which have been valued by this study at \$825 times 5,499 equals \$4,536,675.00.

“Divided by 5,000 shares outstanding....	\$907.33 per share
Less—8% to allow for dealer.....	72.59

Distribution costs and profit.....	<u>\$834.74 per share</u>
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“Carson Estate Co.

“Owns miscellaneous assets having a stipulated value as follows:

“Current Assets	\$201,936.05
Ranch Real Estate	446,418.04
Other Real Estate.....	147,200.00
Total	<u>\$795,554.09</u>
“Current liabilities	\$ 34,157.48
	<u>\$761,396.61</u>
Less—25% Discount to adjust to a reason- able market appraisal for similar type con- cerns	190,349.00
	<u>\$571,047.61</u>
Divided by 7,412 shares outstanding	\$ 77.00 per share

(Testimony of Ralph E. Phillips.)

“In addition, Carson Estate Co. owns:

1,353 Sh. of Dominguez Estate Co.	
\$825 x 1353	\$1,116,225.00
1,785 Sh. of Francis Land Co. \$907.33 x	
1785	1,619,584.00
	<hr/>
	\$2,735,809.00

Divided by 7,412 shares

outstanding \$368.00 per share

“The company owns oil royalties which by stipulation have probable future income for periods beginning June 1, 1941, and ending December 31, 1965, totaling \$476,542.00. By applying the same tax and depletion factor used in valuing the royalty income of Dominguez Estate Co. and applying a present worth discount factor using 6 per cent* compound interest instead of 5 per cent as used in the Dominguez Estate Co., a present worth value for probable future income of \$285,838.00 has been established. This figure divided by 7,412 shares outstanding produces a value of \$38.50 per Sh. [622]

“Summarized, this gives a value to Mis-

cellaneous Assets of.....	\$ 77.00 per sh.
Francis Land Co. and Dominguez Estate	
Co.	368.00 per sh.
Oil Royalty Holdings (Present Worth)	38.50 per sh.

\$483.50

Less—8% for selling costs and profit to
dealer

38.68

Total \$444.82 per sh.”

*Note—A 6% interest figure has been used because of the generally less desirable character of the Carson Estate Oil royalties as compared to those received by the Dominguez Estate Co.

(Testimony of Ralph E. Phillips.)

Now, I have my work papers which I believe can be used to demonstrate the arithmetic of how I arrived at those various calculations, and they are available.

Mr. Melville: Off the record.

The Court: Off the record.

(Discussion off the record.)

Mr. Melville: I ask that these two documents be marked for identification.

The Court: What are they?

Mr. Melville: The work papers of this witness in making his computations showing the various factors that he took into consideration. May they be marked, your Honor?

The Court: They may be marked for identification as Respondent's Exhibit FF.

(The document referred to was marked as Respondent's Exhibit FF, for identification.)

The Court: You may proceed, gentlemen. [623]
By Mr. Melville:

Q. Are the documents marked as Respondent's Exhibit FF the work papers you referred to?

A. Yes, sir.

Mr. Melville: I offer them in evidence, your Honor.

Mr. Mackay: I object to them, if your Honor please, on the ground they are incompetent, irrele-

(Testimony of Ralph E. Phillips.)

vant, and immaterial. It is not proper evidence.

Mr. Melville: It is going to help you out.

The Court: Is the offer withdrawn?

Mr. Melville: I wish your Honor would rule on the objection.

The Court: I don't think the documents themselves constitute proper evidence. The witness puts them in and offers these merely as work sheets and how he worked out the problems of arithmetic.

Mr. Melville: It is only explanatory, your Honor.

The Court: Very well. We will not receive the documents.

By Mr. Melville:

Q. Mr. Phillips, now, in your testimony what was the total value that you used for the oil royalties of the Dominguez Estate Company?

A. The final figure, you mean? [624]

Q. The total value of the—the value of all of the oil royalties of the Dominguez Estate Company as of June 5, 1941. I don't mean per share of stock, but the entire oil royalties. Do you have that figure?

A. After applying the several discounts and formulas as explained, it amounted to \$4,934,391.00.

Q. And what is the figure for the oil royalties of the Carson Estate Company?

A. On the same basis, it is \$285,838.00.

Q. When did you arrive at that value of \$280,000.00 and some?

(Testimony of Ralph E. Phillips.)

A. You mean \$285,000.00 for Carson?

Q. That is right.

A. About 10 days ago after running these tables.

Q. At the time you arrived at that figure, then, you knew nothing whatsoever of the stipulation in this case as to the value of those oil royalties?

A. No, sir.

Mr. Melville: Off the record, please.

(Discussion off the record.)

Mr. Melville: On the record.

By Mr. Melville:

Q. Mr. Phillips, do the work sheets marked for identification as Respondent's Exhibit FF show how you arrived, the detail of arriving, at those appraisals of the oil royalties [625] in the Dominguez Estate Company case, as well as the Carson Estate Company, how you took into account the various adjustments? A. Yes, sir.

Mr. Melville: I again offer these exhibits in evidence, your Honor, to show the detail of taking into account the various factors including the interest and other discounts that have been talked about in this case.

The Witness: I would like to amend my answer if I may. These records do not take into account the 8 per cent discount for dealer's profit and sales costs that I mentioned earlier. This is purely an arithmetical computation arriving at the present worth of the future probable oil royalty income.

(Testimony of Ralph E. Phillips.)

Mr. Mackay: If counsel will let met me take a look at that and defer offering it right now, maybe we can save a little time.

Mr. Melville: Very well (handing).

By Mr. Melville:

Q. Mr. Phillips, in your connection with your firm of Dean, Witter & Company, have you had experience with the stock of the Kern County Land?

A. Yes, sir.

Q. Is there any comparison between the stock of Kern County Land and the stock of these three companies, in your opinion? [626]

A. Yes. The Kern County Land Company was originally a closely held family corporation having few, if any, outside stockholders. That parallel is not existent at the moment because the Kern County Land Company now has a wide number of public stockholders, but at one time there was that parallel between these three family owned companies and the Kern County Land Company.

Mr. Mackay: I object to that, if your Honor please, unless the time be specified, and I move that it be stricken unless he specifies the time. [627]

The Court: Can you state the time?

The Witness: I will say that up until July, 1934, the Kern County Land Company was a closely held family corporation. Thereafter, due to the activities of my firm and others, the stock became in part distributed to the public.

The other parallel between the Dominguez Estate

(Testimony of Ralph E. Phillips.)

Company and Carson Estate Company particularly and the Kern County Land Company is this, that all three companies in common had and currently have substantial land holdings. They had agricultural operations, they had real estate assets outside of the agricultural operations, and they had and have substantial oil royalty income. So, there is a further parallel there in that the operations of those three concerns are along similar and parallel lines.

By Mr. Melville:

Q. When Kern County Land first made its stock available to the public, did you firm have anything to do with its distribution? A. Yes.

Q. Will you tell the Court about that?

A. As of approximately July, 1934, and I may be a little hazy on the date, my concern purchased from a stockholder who wished to sell a substantial percentage of the total outstanding stock of the Kern County Land and sold it to the public. [628]

Q. Upon what basis did you buy that stock?

A. Well, we bought it on a basis of what we considered to be a reasonable price in view of all the circumstances which were then prevelant. That is a long story and I don't think it has any relevancy to this matter, but I will be glad to outline it if you wish.

Q. Did you consider asset value back of the stock? A. Yes.

Q. Mr. Phillips, you have testified as to the values of these three stocks. What do these values

(Testimony of Ralph E. Phillips.)

represent, value to the willing seller, value to the willing buyer, or the price at which your firm would be willing to buy the stocks, or just what do they represent?

A. They represent values that my firm would consider reasonable, values as of that time under those circumstances, were we called upon to buy this stock for distribution to our customers.

Q. And if you had bought the stock at that price, would you have contemplated selling it at a profit?

A. We would probably have attempted to buy it on the basis of the valuations I have used. The eight per cent discount factor I have outlined as being a proper factor would have represented the profit. In other words, the seller would have paid the commission—would have paid us our profit, it would not have been a commission, it would have been a profit to us, but the [629] seller would have paid that rather than the buyer.

Q. Then, as I understand it, if you had made a bid of these prices for these stocks and had turned around and sold them to your clients at the same price, your firm would have derived a profit of eight per cent?

A. That is correct.

Mr. Mackay: If your Honor please,—wait.

The Court: The answer may be stricken.

Mr. Mackay: I object to it on the ground it is incompetent, irrelevant and immaterial. The witness is not yet qualified by his own testimony to pass upon the value of oil royalties. His whole

(Testimony of Ralph E. Phillips.)
testimony is based upon that. He says he knows nothing about it.

Mr. Melville: That is proper cross-examination, it seems to me.

Mr. Mackay: No, you have got to lay your own foundation.

The Court: The question as phrased is objectionable, I think, as to whether or not he would have made a profit.

By Mr. Melville:

Q. If your firm had made a bid for these stocks at the figures that you have testified to and had been successful in buying them at those prices, state whether or not they would have been offered to the public at the same price.

Mr. Mackay: I object to that, if your Honor please, [630] on the same ground.

The Court: It is very speculative, I would think. He has given his estimate of the fair market value. I don't believe the question as phrased is a proper question, Mr. Melville.

By Mr. Melville:

Q. Mr. Phillips, you are familiar with the dealings on the Los Angeles Stock Exchange?

A. In general, yes, sir.

Q. Are there stocks that are traded on the Los Angeles Stock Exchange rather infrequently?

A. Yes, sir.

Q. Will you explain for the record what "bid

(Testimony of Ralph E. Phillips.)

and asked" means in connection with the stock market?

A. The bid side of the market is the price that a willing buyer will pay. The asked side is the price that a willing seller will sell for.

Q. Now, with respect to that, what do these prices that you have testified to in this case represent?

Mr. Mackay: I object to that, if your Honor please. It is incompetent, irrelevant and immaterial.

The Court: Off the record.

(Discussion off the record.)

Mr. Mackay: It is too speculative, if your Honor please. It has no place in the record here.

The Court: Will you read the record back?

(The record was read.)

The Court: He may answer.

Mr. Mackay: Note an exception.

The Court: The exception may be noted.

The Witness: They represent the price that my firm, I believe, would have been willing to pay for the shares involved as of that date.

By Mr. Melville:

Q. Do they represent the bid or the asked?

A. They would represent the bid.

Mr. Mackay: There is no bid. I move that be stricken.

(Testimony of Ralph E. Phillips.)

By Mr. Melville:

Q. Now then,—

The Court: Just a moment. Of course, we should keep in mind the thing that we are trying here is the fair market value, having in mind your hypothetical willing seller having knowledge of the facts and the hypothetical willing buyer having knowledge of the facts. Now, I assume from the witness' testimony that what he is attempting to give us is his idea of the fair market value on the basic date. Isn't that correct?

The Witness: That is correct.

The Court: I don't believe we need to go into the question of bid and asked prices and so on. I think we know in a general way, all of us, what that means. He has given us his idea of fair market value on the basic date and I don't believe that would be helpful, would it, Mr. Melville?

Mr. Melville: Perhaps not, your Honor. Withdraw the question.

By Mr. Melville:

Q. Mr. Phillips, since you have stated that your firm would have been a willing buyer in this hypothetical situation we are dealing with at the prices that you testified to, and you had not found a willing seller at those prices, would your firm have been willing, in your opinion, to have gone up in order to meet any demands on the hypothetical willing seller?

(Testimony of Ralph E. Phillips.)

Mr. Mackay: I object to that, if your Honor please, as too speculative. It is just not proper in this kind of a case.

The Court: I will sustain the objection.

Mr. Melville: Your witness.

Cross Examination

By Mr. Mackay:

Q. Mr. Phillips, did you prepare all these figures yourself?

A. I prepared the formula, yes, sir. [633]

Q. You prepared the formula?

A. Yes, sir.

Q. But did you not check the figures?

A. Yes, sir.

Q. But you did not prepare the figures?

A. No, I did not.

Q. The figures were worked out by someone else, were they?

A. That is correct.

Q. Where did you get the formula from?

A. As I stated earlier, my firm and none of its partners consider themselves to be experts in all lines of endeavor, all lines of business. We employ accountants when we want an accounting job done. We hire lawyers when we seek legal advice. When we want advice on technical matters, such as oil royalty valuations, we rely upon the best talent among qualified oil authorities that we can obtain. This is a formula which was, and we still believe it

(Testimony of Ralph E. Phillips.)

to be, a reliable formula and which was given to us by a qualified engineer.

Q. If your company, Mr. Phillips, were going to contemplate purchasing shares and distributing them to the public, the first thing it would do, particularly if the stock it was going to purchase had underlying assets of oil royalties—your company would want to be pretty sure with respect to the fair market value of the oil royalties, wouldn't they? [634] A. Yes, sir.

Q. And your company would seek the advice of some very competent engineer to give you that?

A. Yes, sir. We have done that.

Q. Have you ever used Paul Paine for that purpose? A. Yes, sir.

Q. Several times? A. Yes, sir.

Q. You regard Paul Paine as a very capable engineer? A. We have employed him.

Q. As a matter of fact, didn't you employ him—I will withdraw that. Now, you say that you are not equipped to pass upon the fair market value of oil royalties? A. That is correct.

Q. That is what I understand. I think you stated, Mr. Phillips, that your fair market value of the Carson Estate oil royalties, arrived at by the use of the formula, was \$285,838.00? I am approximately correct, am I not?

A. That is correct.

Q. Now, let us assume that the average daily production from those oil royalties of Carson on the date we are concerned with, namely, June 5,

(Testimony of Ralph E. Phillips.)

1941, was 200 barrels per day, can you figure out what value there would be to each barrel of oil in the ground?

A. I don't think that is a proper question to ask in [635] this connection and I would——

Q. Why is that?

A. Well, because the valuation of 200 barrels per day—you are asking an abstract question here—would depend upon a lot of factors which are not at issue in this matter, such as the price of oil, tax rates, and so on. They are not in issue and I don't think that is a proper question to ask.

Q. I know, but couldn't you just assume it is a proper question and answer the question?

A. How would I value \$200 barrels per day?

Q. No, I didn't ask you that. I merely asked you to assume that the average daily production on the Carson oil royalties were 200 barrels. You have established a value of \$285,000.00, testified to a value of \$285,000. Now, how much is that per barrel? Can you figure that out?

A. Yes, I could figure that out if you gave me time.

Q. Will you please do that?

A. I won't attempt to do that now. It is a technical——

The Court: I am not sure I understand what you mean by your question, Mr. Mackay.

Mr. Melville: I don't want to limit the scope of the cross examination, your Honor, but it seems to me that he ought to ask questions which are com-

(Testimony of Ralph E. Phillips.)

plete in themselves and not just give him 200 barrels per day as a figure and expect him to assume a whole lot of other factors which are not posed [636] in the question.

The Witness: I have made it clear——

The Court: Just a moment. Mr. Phillips.

Mr. Mackay: I will withdraw that question, your Honor. It is confusing I will grant that.

The Court: All right.

By Mr. Mackay:

Q. You have stated, I think, that in your opinion the value there is \$285,838.00 for the Carson oil royalties? A. Yes.

Q. Now, in the stipulation you also saw, did you, the number of barrels that was estimated?

A. Mr. Mackay, what I did was to place a valuation upon figures of dollar return not barrel return over a period of years, which I understood were agreed to, and all I did was apply the formula that I have explained to you. Now, if you want to get me into other methods, I would have to consult my engineer on it. All I did was to value the stipulated dollar income over a period of years.

Q. And you ignored the barrels?

A. That was not given me. I have no idea what the barrels were. That was never a factor in this matter as far as I am concerned. I was given the dollar return.

Q. I believe the record will show that the barrels per day was not introduced into evidence until

(Testimony of Ralph E. Phillips.)

after this trial [637] started and was introduced by the Petitioner.

A. I have no idea what the barrel factor was.

Mr. Mackay: May I have the stipulation, please?

(The document was handed to Mr. Mackay.)

By Mr. Mackay:

Q. Did I understand you to say that you had been given a copy of these exhibits?

A. All these exhibits that you show me on top there, yes.

Q. What number is that?

Mr. Binnion: 12-L-1.

By Mr. Mackay:

Q. Were you not given a copy of the estimated oil reserves in barrels? A. No, sir.

Q. You were not given that? A. No, sir.

Q. Were you given a copy of the estimated probable future recovery in barrels?

A. No, sir.

Q. You were not? A. Dollars only.

Q. You were only given dollars? So then, your opinion is based solely upon dollars, isn't it?

A. Dollar return, because the dollar return is based upon the price of oil, and I have had no connection whatever [638] with determining the formula for making up this stipulated dollar return over the period of years. I made no effort to value that in any other manner except the use of monetary return.

(Testimony of Ralph E. Phillips.)

Q. What was the price of oil that you used?

A. I have no idea. Dollar return is all I am concerned with.

Q. So you did not consider the price of oil?

A. None whatever, the stipulated value on the oil and gas or what not.

Mr. Melville: Your Honor——

By Mr. Mackay:

Q. Did you ever go on the property?

Mr. Melville: It seems to me, your Honor, that counsel is trying to go back of the stipulation. We have Mr. Paine's future oil royalty income and it is in the stipulation and our witnesses were not asked to go back of that stipulation.

Mr. Mackay: I don't know what your witnesses were asked.

The Court: I would suggest, gentlemen, that perhaps we are making a mountain out of a mole hill. The witness has testified that all he did was to take the stipulated figures given to him with reference to the dollar return, and upon those figures he applied with various factors which he has related and has concluded that the fair market value on the basic [639] date of the right to receive that amount of money as oil royalties was \$285,000.00.

By Mr. Mackay:

Q. Were you given a copy of the stipulation?

A. No.

Q. You were not given a copy of the stipulation?
A. No, sir. I have never seen it.

The Court: Off the record.

(Discussion off the record.)

The Court: I am about to suspend. Will you be able to finish with this witness?

Mr. Mackay: No, your Honor, I cannot before lunch.

The Court: We will suspend at this time until 2:00 o'clock.

(Whereupon, at 12:30 p. m., a recess was taken until 2:00 p. m. of the same day.) [640]

Afternoon Session. 2:00 p. m.

RALPH PHILLIPS,

recalled as a witness for and on behalf of the Respondent, having been previously duly sworn, was further examined and testified as follows:

Cross Examination—(Resumed)

By Mr. Mackay:

Q. Mr. Phillips, I believe you have some explanation to make with respect to the testimony you just gave just before we adjourned.

A. Yes.

The Court: Pardon an interruption. Off the record.

(Discussion off the record.)

The Court: On the record.

The Witness: I believe the question referred to

(Testimony of Ralph Phillips.)

was had I or had I not seen the stipulation between the parties. And I answered the question that I had not seen it. That was not correct. Yesterday or the day before a young gentlemen from the office of the Respondent brought a copy of that stipulation to my office and sat down and asked me to read it. I did read it without realizing what the text of the material was. I did read it carefully. I didn't realize that is what you referred to, if I may so state. I have seen that stipulation between the parties. [641]

By Mr. Mackay:

Q. Now, Mr. Phillips, I think you testified something about the Kern County Land Company and that your company acquired that in 1934, a substantial block of stock. A. Yes.

Q. You acquired that from Mr. Blanding; didn't you?

A. I believe so, yes, sir.

Q. He was pretty old at the time; wasn't he?

A. Yes, sir.

Q. And very anxious to sell? A. Yes.

Q. Didn't you acquire that at a price equivalent to something less than the current assets?

A. We did, and there is an explanation for that. The background of the circumstances were this: Mr. Sinclair was running for Governor in this State. People of property interests and wealth were very much alarmed by the socialistic trend of Government in California.

(Testimony of Ralph Phillips.)

Agriculture had been a highly and profitable venture on a large scale for a number of years. Remember, this was 1934 and we were only just coming out of the first phases of the so-called depression.

Mr. Melville: If your Honor please, I believe it was pretty well established this morning that we shouldn't go too far back of 1941 in making comparisons. We are back [642] to 1934 now, and I would like to object on the ground it is not close enough to our basic date.

The Court: Well, the witness told something about this transaction while on direct. I think it would be perfectly proper for cross examination. The objection will be overruled.

The Witness: Shall I continue?

The Court: You may continue.

By Mr. Mackay:

Q. That stock was purchased by you for around \$33.00 a share?

A. No; \$30.00 a share.

Q. It sold for \$33.00 to the public?

A. We offered it to the public at \$33.00 a share.

Q. You had considerable difficulty selling it at that; didn't you? A. Yes and no.

Q. Well, did you?

A. The most of it sold very quickly.

Q. Well, some of it was a little slow in moving?

A. Perhaps 10 per cent of the amount we acquired was with us for a month or two. But the bulk of it was sold quickly.

(Testimony of Ralph Phillips.)

Q. Some of your firm members had to buy the balance of 1500 shares?

A. I wouldn't say they had to. They bought it by choice. I was one of them. I regarded that favorably. [643]

Q. By the way, at that time didn't the Kern County Land Company have about 68,000 head of cattle? A. That I couldn't say.

Q. They had a large bunch of cattle?

A. Something over 60,000 head perhaps.

Q. They had three or four million acres of ground?

A. No, they had a little over a million acres in Arizona and New Mexico, which was considered to have little or no value. And they had 513,000 acres in Kern County, California.

Q. A lot of it was agricultural land; wasn't it?

A. Well, it had no other value except for agriculture, except for a small amount of oil which had been found in earlier years, but which was considered to have been almost fully completed.

Q. They did own the water rights in the Kern River; didn't they?

A. Yes, and they were valuable.

Q. Is that your understanding that the Dominguez Estate has a lot of agricultural land to be compared with the agricultural land of the Kern County? A. Nothing like the same scale.

Q. Do you know whether they have an agricultural land? A. It so states.

Q. Agricultural land?

(Testimony of Ralph Phillips.)

A. Ranch land. I presume ranch land means agricultural [644] land.

Q. You don't know whether they were producing crops on it?

A. I stated in my first qualifying remarks that I had not seen the properties. I had not seen the property, had made no attempted verification. I took the figures as stipulated and I will rely upon them until I am given some other basis.

Q. I think you stated that you used a procedure whereby you took the total estimated income and then you applied a certain factor there for taxes. Is that what you did?

A. If you are referring to oil royalties, yes, sir.

Q. Yes. Then you also, after you did that, you took a discount of that figure by five per cent; is that right?

A. Well, the five per cent was not five percent of the total income, it was five per cent at compound interest, figured annually of the total. It figured out a discount factor of more than 29 per cent of the total figure, but it was five per cent compounded semi-annually.

Q. Then you came to the conclusion that would be the fair market value; didn't you?

A. Yes.

Q. What do you mean by fair market value?

A. A price which I would be willing to buy it for.

Q. And your figure was how much? [645]

(Testimony of Ralph Phillips.)

A. If you are talking about Dominguez Estate Company it was \$4,934,391.00.

Q. Now, do you mean to tell the Court that your firm would be satisfied with a five per cent profit on that deal?

A. That isn't what I stated at all.

Q. Do you think you could recommend to your clients to purchase that on the basis they would get a five per cent return?

A. They would get the return of their principal, plus five per cent at compound interest.

Q. That is what I mean. They would get a return of their principal, plus five per cent.

A. That is the method we used.

Q. Do you think that is sufficient return for oil properties?

A. You are getting your money back.

Q. Is that all the prospective buyer is interested in?

A. This is a basis we would have been willing to buy it, I am sure, at that time.

Q. How long would it take to get your money back?

A. A period of about 25 years.

Q. Well, suppose you had a good corporate bond, what rate of return would you want on that capital back, plus——

A. As of 1941, a good corporate bond would have produced a rate of return of about 3-3/4ths per cent; currently about [646] 2-3/4ths.

(Testimony of Ralph Phillips.)

Q. Now, you speak about this procedure. Where did you get that procedure?

A. This formula for valuing?

Q. Yes.

A. From an engineer in whom we have confidence.

Q. You call it a formula?

A. Yes, it is a formula.

Q. What is the formula?

A. I have explained it. Do you want me to go into it again?

Q. You read it. I wish you would explain it to me now.

A. It is the stipulated probable oil royalties which you people have, as I understand, agreed upon as the rate per year to be returned from the oil royalty income, less a factor representing taxes, based at the then existent tax rates, which were California Franchise tax and Federal Corporation tax. That produced a figure which was probable net income after taxes; in dollars mind you, a probable net income after taxes. To that I have applied a present worth factor, calculated at five per cent compound interest figured annually.

By applying those series of deductions the figure of eight million six hundred sixty thousand, which was the total amount which would be received by stipulation, excluding the [647] amount after 1965, would be reduced to \$4,934,391.00. A reduction of about 40 per cent in the total gross return.

Q. Now, did the engineer tell you that figure was market value?

A. I beg your pardon.

(Testimony of Ralph Phillips.)

Q. Did that engineer tell you that figure was market value?

A. We have had no engineer review these figures. I am merely applying a formula or a series of reductions to a gross figure which would have been the result had we employed our engineer; at least, we have reason to believe that would have resulted.

Q. Where did you get the formula?

A. I explained that to you.

Q. No, you haven't. Was it written out?

A. It was used on more than one occasion by this engineer.

Q. Was it ever displayed by that engineer to you? A. Yes.

Q. In what instance?

A. In the appraisal of the Dominguez Oil Field property.

Q. Have you seen a copy of that?

A. Yes.

Q. Do you have a copy on your desk?

A. Yes. [648]

Mr. Melville: Introduce it in evidence.

By Mr. Mackay:

Q. Will you please refer to page 1?

The Court: Page 1 of what?

Mr. Mackay: Of that appraisal report he has before him.

The Witness: Yes, sir.

(Testimony of Ralph Phillips.)

By Mr. Mackay:

Q. That is the procedure you followed in estimating the value you place here?

A. No, this is a little different.

The Court: May I inquire, what is it you are looking at? Is it in evidence? That is all I wanted to know.

Mr. Mackay: No, this is not in evidence.

The Court: I see. All right.

The Witness: It is a little difficult in that this report which was prepared by Mr. Paul Paine, who is present here,—he may be willing to explain the situation himself; he prepared the report.

By Mr. Mackay:

Q. Well, I am interested in your explanation right now.

A. That is qualified by stating that he not only had to estimate the barrels of returnable oil over a period of years, but furthermore the rate of return, the price of oil and the taxes included. [649]

Q. All right.

A. Now, you may go on. I will explain. I am prepared to.

Q. That is fine. Then in his report Mr. Paine estimated the net oil reserves at approximately 41,000,000 barrels; doesn't he?

A. Yes, 41,000,000 barrels.

Q. And the discounted future value per share was \$66.64.

A. Yes.

Q. What was the procedure you followed here?

A. You have engaged in a number of short cuts.

(Testimony of Ralph Phillips.)

Mr. Melville: Your Honor, I ask opposing counsel if he is trying to cross examine Mr. Paine's method of valuation of the method this witness has used——

Mr. Mackay: Well, I am trying to find out what this witness did and how he arrived at it. I have that privilege.

The Court: I doubt if there is anything for me to rule upon. You may ask another question, Mr. Mackay.

Mr. Mackay: Will you please read that question?

(The record was read.)

By Mr. Mackay:

Q. Now, Mr. Paine has reduced that to per share, based upon 400,000 shares, and got \$66.74 per share?

A. That is right. [650]

Q. Is that the equivalent of the four hundred ninety one thousand you arrived at?

Mr. Melville: If your Honor please, if we are going to analyze the method of appraisal, I think we ought to put the whole thing in evidence and not pick out parts of it here and there and elsewhere.

Mr. Mackay: I am amazed.

Mr. Melville: It is your privilege.

Mr. Mackay: All I am trying to find out is to find out what formula the witness used and how he applied it.

The Court: The form of your question is, to say the least, a little bit difficult or ambiguous, so

(Testimony of Ralph Phillips.)

far as I am concerned. You are talking about some report that you and the witness seem to have in your hands, and you refer to it in general terms, and yet I don't have it, so I will have difficulty in re-reading this record to know exactly what you were talking about.

If you wish to talk about the report or what he has done, and can put it in language or figures that may be understood from a cold record in this case, it would be more helpful to me, I believe.

Mr. Mackay: Yes. I will withdraw that question.

Mr. Melville: There is only about six lines to that computation. Why don't we put it in?

The Court: You may proceed with the cross examination [651] of the witness.

By Mr. Mackay:

Q. Now, you arrived at a figure of \$4,900,000, approximately; didn't you? A. Yes.

Q. Now, that is your value; isn't it?

A. That is present worth value of the oil, probable oil receipts after taxes.

Q. Was that fair market value?

A. I would consider it to be. I have already stated that I believe that my firm would have been prepared to make that kind of an offer, based upon that figure.

Q. Now, do you know how many shares there are outstanding in Dominguez Estate Company?

(Testimony of Ralph Phillips.)

A. I couldn't tell you what are outstanding—now, as of this date, I do.

Q. How many? A. 10,499.

Q. Will you divide 10,499 into four million, the figure you have there?

A. Yes, I have done so. It is \$470.00.

Q. \$470.00? A. Yes.

Q. In the formula you say you used, which you got from Mr Paul Paine, Mr. Paul Paine showed a per share value there [652] of per share present worth of \$66.74; isn't that right?

A. If you are still talking about the Dominguez Oil Fields, Ltd., that is correct.

Q. Yes. A. Yes, sir.

Q. What did you pay for the stock?

A. What did who pay for the stock?

Q. Dean Witter.

A. I don't know what you are referring to. You haven't asked the question, if you are talking about Dominguez Oil Field Estate.

Q. Yes.

A. You have asked no leading question up to that point. What did we pay for what stock and when?

Q. Did Dean Witter buy the stock of Dominguez Oil Fields Company?

A. We dealt in it frequently.

Q. Did it do it in—did you make a public offering of the Dominguez Oil Field Company stock?

A. Yes.

(Testimony of Ralph Phillips.)

Q. And that was done about 1938; wasn't it?

A. Yes, sir.

Q. That was done about the same time of the appraisal on the Dominguez Oil Field stock, the same time Mr. Paine made——

A. Mr. Paine made this report, in support of our bid [653] for that stock.

Q. How much did you offer that to the public for?

A. I believe the price was \$36.00 a share. I would like to add one qualifying remark, however. The stock was listed on the New York Curb Exchange and was dealt in on the San Francisco Stock Exchange unlisted section, and had been selling for a higher price than \$36.00 per share.

Q. Isn't it a fact that you bought it for \$32.50?

A. I couldn't say the prospectus supporting that.

Q. If I show you the prospectus it probably will refresh your memory.

A. I think so. That is six years ago. That is correct; \$32.50.

Q. Isn't it a fact you paid \$32.50 for it?

A. It is.

Q. And you sold it to the public for——

A. \$36.00; that is correct.

Q. And at that time you had been advised by Mr. Paul Paine that the present worth of that was \$66.74 per share?

A. That is correct. And our purchase at \$32.50 was a matter of negotiation between the seller and the willing purchaser.

(Testimony of Ralph Phillips.)

Q. Well now, why didn't you reduce your present worth that you derived in Dominguez to conform to the so-called formula of Mr. Paine? [654]

A. Dominguez is a working interest.

Q. It is a working interest?

A. I say Dominguez Oil Field, Ltd., is a working interest, only it involves fractional royalties on several leases, whereas the Dominguez Estate Company is a proprietary interest.

Q. Well, that wouldn't make any difference; would it? A. It would to me.

Q. Would it really? A. Yes.

Q. Would it to Dean Witter & Company?

A. All I can say, Mr. Mackay, is I have been asked to make a report of what my firm would probably pay for these shares, and I have given you an answer.

Now, I don't propose to change that answer by your cross examination methods. I am telling you what I am prepared to state as a fact.

Q. Do you mean to tell this Court and to represent, in view of your testimony, that Dean Witter & Company would go out here and would have gone out and bought that stock in the Dominguez Estate Company at a value of—based upon the value of the oil wells at \$4,900,000.00 without getting an engineer to appraise it?

A. I am not asked to state that. I think we would have, yes. [655]

Q. This is purely hypothetical. Without getting an engineer?

(Testimony of Ralph Phillips.)

A. No, we would have relied on an engineer. I am given the facts the engineers would bring me; by stipulation I understand you have agreed these are the facts.

Q. Don't you understand in the Paul Paine reports I have referred to, he has given the per share worth and the stock was bought for less than half?

A. I understand.

Q. Wouldn't you follow the same procedure in buying Dominguez, as you would the oil fields, Dominguez Oil Fields?

A. No, we wouldn't. We would follow the same general formula. In calculating the present worth, we would divide by the number of shares to arrive at what we would pay for it. I gave you that figure.

Q. Did you take into consideration the fact there may be an earthquake and you wouldn't get all the income set forth in that exhibit?

A. Yes.

Q. What discount did you give for that?

A. None.

Q. Did you take into consideration that there may be a pro-ration of oil and restriction on production?

A. That has no part of that, if you let me answer that, because you have stipulated these will be the returns by years; [656] whether they are pro-rated or not is not a part of my consideration.

Mr. Melville: If your Honor please, the Petitioner hasn't established the market conditions for stocks and bonds in 1938 are comparable to the

(Testimony of Ralph Phillips.)

market conditions in 1941. I think he has gone far enough with this line of cross examination.

The Witness: I just saw this stipulation just yesterday. I have looked at it once. If you are going to ask me questions concerning it, I would like to refresh my memory.

By Mr. Mackay:

Q. You can take all the time you want. Will you please refer to page 5?

A. (Witness complies.)

Mr. Melville: Your Honor, I might state at this time I am going to object to the further continuance of this line of cross examination, until the Petitioner has established that there is any direct relation between market conditions in 1938 and 1941.

Mr. Mackay: If your Honor please, I am not here to try——

The Court: I don't seem to have any question before me that needs to be ruled upon at this time, gentlemen. I will hear your objections whenever they are made, and you may proceed with the cross examination, Mr. Mackay.

By Mr. Mackay: [657]

Q. Have you read K?

A. I am reading K. Yes.

Q. Now, did you understand that the stipulation merely said that Joint Exhibit 11-K is the estimated amount in barrels of oil of ultimate probable future production?

(Testimony of Ralph Phillips.)

A. If you will allow me, on line 21 it says, "Joint Exhibit 11-K (2) is a computation, based upon said Joint Exhibit 11-K (1) and upon an agreed price per barrel of oil, said price being net revenue per barrel of royalty oil received from January 1, to May 31, 1941."

I only have valued the dollar figures as presented to me by the Respondent. I have taken into account at no time the amount of barrels to be received.

Q. Well, I know, but——

A. I stated that in the beginning.

Q. Joint Exhibit 11-K——

A. I do not have those exhibits before me, so I don't know what they say.

Q. Do you want them?

A. I would like to see them.

Q. You were furnished with copies of all these exhibits; were you not? A. No.

Q. You weren't?

A. What I used was Joint Exhibit—or the summarization [658] of Joint Exhibit 11-K (2), which is calculated in dollars, not barrels.

Q. Now, you are familiar with the statement there, "Joint Exhibit 11-K (2) is a computation, based upon said Joint Exhibit 11-K (1)——"

A. I have read that after having prepared my estimate. My Estimates were completed before I ever saw that stipulation. But I did have, as I stated to you a moment ago, a summarization of the results of Joint Exhibit 11-K (2) and that is all.

(Testimony of Ralph Phillips.)

Q. Well, but when you read K (2), Joint Exhibit K (2) you weren't familiar with Joint Exhibit 11-K (1)?

A. I had never seen it at the time I made my computation.

Mr. Melville: I might add, for the record, the Respondent hadn't, either, at that time.

By Mr. Mackay:

Q. Now, do you mean to tell the Court, Mr. Phillips, that your company would buy oil properties, oil royalties without investigating the daily average production of the wells?

A. No, we would not.

Q. Nor would they buy oil properties without a pretty good estimate of the number of barrels to be recovered; would they?

A. I will go further than that. If it will interest [659] you, we wouldn't buy the oil royalties under any circumstances, without a competent engineer's full report on it.

However, if you will allow me to finish, I have assumed that after the engineer finished his report he would bring to us a dollar income figure for the years, and the rate would be spelled out in that dollar return, showing the curve as these figures do.

Q. Well, but suppose you had an engineer's report, with an estimate of the barrels and the estimate of probable future income?

A. That is what I had; without the barrels.

Q. If it were merely an estimate of future in-

(Testimony of Ralph Phillips.)

come, wouldn't you get somebody to look into that and see whether or not you wanted to pay the price for it?

A. Well, I think it has been made clear.

Mr. Melville: I object. He is asking this witness if he wants to disagree with the stipulated facts in this case. I see no reason why we should go back of the stipulated facts.

Mr. Mackay: I am not going back. I am just merely asking the witness if his firm would buy merely upon an estimate of future earnings, without considering——

The Witness: No. I understand these figures have been agreed upon by stipulation.

By Mr. Mackay:

Q. As merely estimates. [660]

A. As estimates; take it that way.

Q. Yes.

A. And that is all I prepared, was an estimate.

Q. I think you stated you had no experience in valuing oil royalties.

A. That is correct. I am not an engineer. I made that clear at the first. We know where to buy talent.

Q. If your firm was anticipating purchasing some oil royalties, would you give any consideration to the value of the oil in the ground?

A. Certainly.

(Testimony of Ralph Phillips.)

Q. What did that amount to in the Dominguez case, per share?

A. Do you refer to the Dominguez Fields, Ltd., Company?

Q. No, Dominguez Estate—that is right.

A. Which is it?

Q. I should have said Dominguez Oil Fields.

A. Well, according to our engineer's report it was approximately 41,272,470 barrels.

The Court: Should we go into that? Isn't that an entirely different setup?

Mr. Melville: Your Honor, I think I can explain the situation that is confronting Mr. Mackay.

Mr. Mackay: No, I don't think I want the explanation right now, Colonel. Thanks. [661]

Mr. Melville: You are welcome.

By Mr. Mackay:

Q. Did you check your result against any other forms of appraisal?

A. The result of what, my estimate here?

Q. Yes.

A. No, except to apply the same general practice of valuation that we believe to be sound.

Q. Well, do you think your firm would go out and make a big purchase like this without having it checked by someone?

A. I think so.

Q. They would have had somebody check it?

A. Yes, we would have had an engineer check it. You have developed that before, Mr. Mackay: I have answered that question twice.

(Testimony of Ralph Phillips.)

Q. What consideration did you give to the past earnings?

A. I looked at them.

Q. What consideration did you give to them?

A. I felt a 10 per cent return was adequate to get your money back, which is in part return of capital. If you will refer to your average earnings for the period preceding, as we do, you will find that they had paid in dividends something in excess of \$70.00 a share, or whatever it is. It is about a 10 per cent return. Perhaps my figures are at fault. I don't have them before me. [662]

Q. Are you talking about earnings or dividends?

A. Well, in a liquidating company they are generally the same. They are in the case of Dominguez Oil Fields, Ltd., which is one of your properties.

Q. The Dominguez Estate Company, do you think the earnings are the same as dividends?

A. Not necessarily. It all depends on the way they handle them.

Q. Have you considered the earnings?

A. Not very materially, no.

Q. You didn't give much thought to that?

A. Not very much, no.

Mr. Mackay: That is all.

Redirect Examination

By Mr. Melville:

Q. You made a comparison of the situation with respect to Kern County Land and the Dominguez Estate Company back in 1938 for the Petitioners'

(Testimony of Ralph Phillips.)

counsel. Would you bring that up to date and make a comparison as to the market value of Kern County stock in 1941, in relation to the appraised value of the assets? A. As of 1941?

Mr. Mackay: I object to that.

By Mr. Melville:

Q. Yes. Bring it up to date, to 1941. [663]

Mr. Mackay: I object to that as not proper redirect examination.

The Court: I doubt if it is proper redirect, Mr. Melville:

By Mr. Melville:

Q. Mr. Phillips, are you familiar with the market value of Kern County Land stock in 1941?

A. In general. I wouldn't trust my memory now to state what the exact quotations were; in general I can tell you.

Q. Have you ever had an occasion, in connection with your appraisal in this case, to check the relationship between the fair market value or the appraised value of the assets of Kern County——

Mr. Mackay: Which is it? I object to that.

The Court: Let's complete the question and we will hear your objection. Proceed.

By Mr. Melville:

Q. ——with the market value of its stock in 1941?

Mr. Mackay: May I have the question, please?

(The question was read.)

(Testimony of Ralph Phillips.)

Mr. Mackay: I object to it, if your Honor please, as not proper redirect examination.

Mr. Melville: I think it is proper redirect, your Honor. They went into the situation in 1938.

The Court: Well, it doesn't seem to me that we are having much to do with Kern County real estate. I can't [664] see where it would be a proper part of redirect examination of this witness. We are not vitally concerned with the Kern County real estate or whether he made a good appraisal there or whether he didn't.

Mr. Melville: We are concerned, your Honor, with the appraisal methods of this witness. If after he has made his appraisal in this case he has compared it with the fair market value as established by the actual market of Kern County Land, which is a comparable company—both Petitioners' witnesses and ours have so testified—if he establishes by such a comparison that there is a direct relation between the fair market value of the stock of Kern County Land, as established by the actual market to its asset value, back of the stock, and that relationship is substantially the same as the relationship which he found in this case, it seems to me it would establish by an actual market that his methods are sound.

The Court: Well, it would be perhaps merely self-serving and his own opinion. At one time he made a good guess, and from that you are expecting us to assume that he is making a good guess this time.

(Testimony of Ralph Phillips.)

Mr. Melville: No, your Honor. He made no guess in Kern County. The buying public bought and sold Kern County stock.

The Court: Is it the essence of your inquiry now [665] as to whether or not this witness, in the light of his subsequent experience, feels that he was correct in evaluating the Kern County property?

Mr. Melville: He never evaluated the Kern County property.

The Court: What has the Kern County property got to do with it?

Mr. Melville: That is what I tried to point out a half hour before.

The Court: I have heretofore wondered what the Kern County property had to do with it.

Mr. Melville: If it had anything to do with it in comparing 1938 with 1941, then I submit that 1941, compared with 1941 is a fair question.

The Court: We will hear what he has to say on it.

(The question was read.)

The Witness: Well, my firm, aside from its initial purchase of the Kern County Land Company stock, has been called upon to make bids for substantial sums of it or quantities of it, I should say, from time to time, by people who wish to sell. In addition, there has been a regular over-counter market between dealers for the stock.

In 1939, which is the closest approximate date to the question date, we employed engineering counsel

(Testimony of Ralph Phillips.)

to appraise the oil values of the Kern County Land Company as of that date. [666] The methods used were quite comparable to the methods used——

Mr. Mackay: Your Honor, I object to that. We haven't got that report here.

The Court: Overruled. Let's hear his answer.

The Witness: The methods used were quite comparable to the methods used by Mr. Paine in valuing the Dominguez Oil Fields, Ltd., stock a couple of years earlier, or a year earlier, for us. Mr. Paine did not make that report, however. It was made by another engineer.

Mr. Mackay: I move that be stricken, if your Honor please; it is pure hearsay.

The Witness: It isn't pure hearsay.

Mr. Mackay: It isn't proper redirect examination.

The Court: Overruled. Proceed with the answer.

The Witness: It is my recollection and I don't have the report before me, either. It is my recollection that the value of the oil alone fairly represented the full price of the stock as indicated by market quotations at the time. In addition, there were other assets. There was land and cattle and a good deal of cash and the equivalent of cash. But taken on the basis of the large number of shares outstanding, I would guess that the other assets did not contribute very much per share to the total valuation of Kern County Land stock.

The primary factor was that of oil interests. But the market value, the oil at—approximately all of

(Testimony of Ralph Phillips.)

the oil [667] that was apparent by these reports.

However, there was much exploration being conducted at the time and there was an unknown factor which the engineers chose to place some rather nominal value upon, that is, for future discoveries. And therein the parallel did not appear to be quite the same as in this instant case. Does that answer your question?

Mr. Mackay: I move that be stricken as all hearsay; incompetent, irrelevant and immaterial.

The Court: I think it has very little probative value. It isn't altogether hearsay. We will let it stand for whatever it may be worth.

By Mr. Melville:

Q. Mr. Phillips, will you read into the record, please, the entire formula that Mr. Mackay went into on his cross examination?

Mr. Mackay: In what?

Mr. Melville: From Mr. Paine's report.

The Court: Let's hear that question again.

(The question was read.)

Mr. Melville: I withdraw that question.

By Mr. Melville:

Q. Are you familiar with the general market conditions as revealed by the Dow Jones averages or by other measures in 1938, as compared to 1941?

A. I wouldn't trust my memory, but I believe that in 1938 the market was reflecting a rather poor year for industry. 1937 was a very good year. 1938 was a rather poor year. It was a mild re-

(Testimony of Ralph Phillips.)

currence of the depression. In 1941 we were well on our way toward the war stimulus which later affected the market. While I say I would not trust my memory, it is my belief that the Dow Jones averages were at least 10 per cent higher than they were in 1938.

Q. Mr. Phillips, with the kind permission of opposing counsel, will you state, in connection with your qualifications, what the National Association of Securities Dealers, Inc., is, and what your connection with that Association is?

A. The National Association of Securities Dealers, Inc., is a voluntary association composed of practically all of the people in the securities business, created by an Act of Congress known as the Maloney amendment to the Securities and Exchange Act of 1934. That amendment provided for regular self-regulation on the part of the dealers and others engaged in the business. And, as I have stated, practically all the people in my business are members of that Association.

Q. What is your position with that Association?

A. Currently I am chairman of that Association's board of governors.

Q. Is that the head of it? A. Yes, sir.

Mr. Melville: No more questions.

Recross Examination

By Mr. Mackay:

Q. You said, I think, in 1941 we were pretty well on our way to war stimulus.

(Testimony of Ralph Phillips.)

A. Perhaps you quarrel with the term "war-stimulus."

Q. I am not quarreling with anything. I am asking you a simple question.

A. I stated so, yes.

Q. At that time, wasn't there quite a stimulation for increased taxes?

A. I believe that a defense tax of 10 per cent had been added to the general corporate taxes at that time. We were not yet in war, unless you refer to the very last few weeks of 1941.

Q. No, I am referring to June 5, 1941.

A. The tax structure at that time was a matter which can be demonstrated. It included, as I recall, a defense tax, so-called, of 10 per cent.

Q. Weren't there a lot of statements being issued that would indicate that the taxes were going to be greatly increased immediately?

A. There are a lot of statements currently they are going to be immediately decreased; it hasn't occurred.

Q. I asked you if it wasn't at that time. I know what is going on at this time. [670]

A. I can't tell you what was going on at that time, except by hearsay.

Q. You take the Wall Street Journal?

A. Yes.

Q. Look at this (indicating). This is the San Francisco-Los Angeles issue for June 5, 1941. You read this every morning?

A. Sometimes.

(Testimony of Ralph Phillips.)

Q. It says: "Defense Outlays to Tax \$1 Billion a Month Soon.

"June, May Pass \$900,000,000,000 Figure.

"Excess Profits Tax Bill Modeled on Present Act Assured by Vote of Committee; Rates to be Stiffer."

A. I can read it.

Mr. Melville: Would you like to put the whole copy in?

Mr. Mackay: Do you want it in?

Mr. Melville: I don't care.

Mr. Mackay: Put it in if you want it.

By Mr. Mackay:

Q. If you expected a war stimulus or some stimulus from business, didn't you or Dean Witter expect quite a stimulation in the amount of taxes to be imposed? A. It might have followed.

Q. It was reasonable to expect taxes to go up after these statements; wasn't it? You are influenced by the Wall [671] Street Journal, aren't you?

A. Not very much. I read it factually, not for opinions.

Q. Realizing there was going to be a war and that we had——

Mr. Melville: You are assuming. Anybody couldn't realize there was going to be a war in 1941; it wasn't a realization.

Mr. Mackay: I will withdraw that.

The Witness: If you would like me to withdraw that, I would be glad to.

(Testimony of Ralph Phillips.)

By Mr. Mackay:

Q. Let me ask the questions. You knew the Draft Bill had been passed and they were building up a strong Army?

A. I wouldn't trust my memory. I knew that happened at some time, but I don't remember the date; perhaps at that time.

Q. Dean Witter, trying to value the estimated income on June 5, 1941, wouldn't have Dean Witter given some consideration to the foreseeable increase in taxes at that time?

A. It might have borne some weight, but not any material weight. Taxes were already very high, Mr. Mackay. Not in the light of subsequent developments, you understand; in the light of what had been the tax rate up to that time. A 10 per cent addition to the tax caused every corporation executive [672] in the country to scream; he was very unhappy about it.

Q. That is quite right. That had quite an effect upon the stocks; didn't it?

A. I don't believe it did.

Q. You don't believe so?

A. No, I don't believe so.

Q. You didn't take into consideration any expected rise in taxes when you arrived at your value, did you?

A. No. I took the existent rates as of that date.

Q. Who gave them to you?

A. It is a matter of record.

(Testimony of Ralph Phillips.)

Q. Who gave them to you?

A. I looked them up. No one gave them to me. I looked them up. I will spell them out for you, if you wish.

Q. You are very helpful.

Mr. Melville: He certainly is.

Mr. Mackay: That is all.

The Court: Is that all from this witness?

Mr. Melville: Just a moment, your Honor. No more questions.

The Court: You may stand aside, Mr. Phillips.

(Witness excused.)

Mr. Melville: I will call Mr. Gally.

I again make the offer, your Honor, in view of the fact that the exhibit goes through this detail and sets forth [673] the method used by this appraiser.

The Court: He has told us what it all is. I don't particularly care if you want it in evidence. I don't see where it is particularly helpful.

Mr. Melville: If it wouldn't help your Honor, it certainly wouldn't help anyone else.

The Court: It is just arithmetic of it. He has already told us in the testimony what he did.

Mr. Melville: Very well, your Honor.

JOHN GALLY

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

(Testimony of John Gally.)

Direct Examination

The Clerk: Your full name for the record, please.

The Witness: John Gally.

By Mr. Melville:

Q. Mr. Gally, what is your business?

A. I am a customer's broker.

Q. How long have you been engaged in that business? A. About seven years, now.

Q. Would you please state for the record your educational and professional qualifications?

A. Educational first?

Q. You may refer to any notes you have. Yes.

A. It is simply a matter of dates. I was first interested in economics in London in 1911 to 1913 at Birkbeck College, and also at Polytechnic in London; I took a course in finance.

Then I came back to Wall Street in 1918 after the war and became a partner in T. L. Sexsmith & Company. I am skipping a few years just to make it easier to make progress. That firm was a member of the Consolidated Stock Exchange.

Then I became a partner of the firm of P. F. Cusick & Company, members of the New York Stock Exchange.

In 1923 I came out to California on account of my wife's health and founded a magazine and also purchased a magazine on finance; one was known as "Finance & Trade," a weekly; the other was the

(Testimony of John Gally.)

"Magazine of Western Finance." I also had an insurance publication which I purchased, known as "The Adjuster." I sold out these publications in 1928.

Of course, I also owned other financial publications, such as "The Pocket Manual of Western Securities," which was published in Los Angeles and San Francisco. I also ran "Gally's Financial Service."

Then I had an investment counsel license from the Corporation Department for eight years. And that brings me up to date to the customer's broker business, which I entered in 1938, with the Bank of America.

Q. Do you have any other qualifications which you wish [675] to state? Does that complete your list?

A. Except that I handle the accounts of a number of clients who are interested in oil securities and many other types of securities.

Q. Have you had experience in appraising oil royalties? A. I have.

Q. Would you briefly state that?

A. In trading in oil royalties we are called upon to make an offer or bid on securities that come over the counter. I have nothing to do, of course, with the listed oil royalties which are traded in the usual manner on the various exchanges.

Q. Are you speaking now of the securities or stocks of oil royalty companies or the oil royalties themselves? A. The oil royalty stocks.

(Testimony of John Gally.)

Q. Have you ever had any experience in appraising the oil royalties themselves?

A. I have not.

Q. Are you familiar with the yardsticks which are used by the buyers and sellers in measuring oil royalties which are bought and sold?

A. I am.

Q. Are oil royalties bought and sold between common laymen, just like laymen buy stocks and bonds?

A. They are. [676]

Q. Does each buyer and seller have oil securities at the time the trade is made, have before them a complete engineer's report as to the oil properties back of the oil royalties?

Mr. Mackay: I object to that as a leading question.

The Court: Objection sustained.

By Mr. Melville:

Q. On what basis, Mr. Gally, do buyers and sellers deal in oil royalties?

Mr. Mackay: I object to that as incompetent, irrelevant and immaterial.

The Court: If he knows he may answer.

The Witness: As a matter of practical basis we evaluate oil royalties on so many times earnings of the past year for which a definite record is obtainable.

By Mr. Melville:

Q. How many times earnings is accepted as sound?

(Testimony of John Gally.)

A. If the royalty has many years to run, depending, of course, upon the length of time the wells have already run, and the nature of the field and various other conditions, such as comparisons of other wells in that field, we estimate from eight to ten times, a fair number of times last year's earnings, for the evaluation of those oil royalties.

Q. What is that figure you use?

A. I use eight as my figure. [677]

Mr. Melville: Did opposing counsel state he wanted a short recess?

Mr. Mackay: Yes.

The Court: We will suspend at this time for a short recess.

(A short recess was taken.)

The Court: You may proceed, gentlemen.

By Mr. Melville:

Q. Mr. Gally, have you seen and studied the stipulations of fact and exhibits in this case?

A. I have.

Q. Have you been furnished with copies for your retention and use of such exhibits as you felt you wanted in order to arrive at an opinion of the fair market value of the stocks of the Dominguez Estate Company, Francis Land Company, and Carson Estate Company as of June 5, 1941?

A. I have.

Q. On the basis of the stipulation and all of the exhibits, have you formed an opinion as to the fair

(Testimony of John Gally.)

market value of those stocks as of that date?

A. I have.

Q. Will you please state, in your own words, what your opinion is and how you arrived at it?

A. May I refer to my notes?

The Court: Yes. [678]

By Mr. Melville:

Q. Yes.

A. In closely held corporations as these, I regard the fair market value of assets back of the stocks as being the best measure of their value. In addition to the actual assets which have been stipulated in this case, I had to estimate the oil royalty figures on the basis on which a high grade royalty of this kind would be figured by a practical broker or buyer or seller in the business. The balance of assets as stipulated in the figures I have received from the Government I find the total \$4,979,699.00, which, divided by the number of shares outstanding, would give a per share value of \$474.30. This figure, I understand, has been stipulated in the agreement that I have seen.

The oil royalties I have figured on the basis of the nearest possible market valuation I could find for a similar property, which I have found in the Dominguez Oil Fields Company, which is operating in the same field and has some of the principal oil leases the same as Dominguez Estate Company.

On the date in question, June 5, 1941,—By the way, I have obtained my information about the

(Testimony of John Gally.)

earnings of Dominguez Oil Fields from Walker's Manual of Pacific Coast Securities, page 392. I have obtained my market quotation on June 5, 1941, from the Wall Street Journal as of that date. Both of these sources have information I consider reliable [679] in our business.

The net earnings of Dominguez Fields, which I am using as a base for estimating the number of times earnings the comparable stock was selling for in the actual market on that date, I find that the nearest full year figures in Walker's Manual in 1941 covered the year 1940, and net earnings before depreciation and depletion amounted to \$1,460,-887.00.

This divided by the 400,000 shares outstanding at that time of Dominguez Oil Fields Company, multiplied by the actual bid in effect on that date of thirty for Dominguez Oil Fields stock, makes a total market value at the quoted price of \$12,000,-000.00. This equals 8.2 times earnings.

I might add there I looked up the quotations, the actual sales prior to—the only one I could find was on June 4th, the previous sale of 165 shares of Dominguez Oil, which sold on the San Francisco Stock Exchange that day at thirty, and that was the low for that week. The total quotations for the week were contained in the Monday summary of the Wall Street Journal on June 9th, which showed thirty and one-eighth high and thirty low and thirty last.

With that as a conservative base for estimating the oil royalties for Dominguez Estate Company, I

(Testimony of John Gally.)

find the per share valuation of \$387.16 for the oil royalties figured on the basis of 8.2 times 1940 earnings. Adding the figure of \$387.16 of the value, the fair market value of the oil [680] royalties, to the stipulated per share value of the Dominguez Estate Company, I obtain a total valuation of the Dominguez Estate Company stock on June 5, 1941, of \$861.46.

I might add here that I have figured the valuation of Dominguez Estate Company stock on another basis, which I will explain later on, as I wish to finish with Francis Land Company and the Carson Estate Company valuations on this basis first.

Francis Land Company, on the basis of the known assets as of June 5, 1941, showed 1 1/10th shares of Dominguez Estate in relation to one share of Francis Land Company. This is equivalent to 1/10th—to simplify the valuation—1/10th more than the value of the Dominguez Estate shown above, or \$86.16 added to the Dominguez Estate valuation gives me \$947.60 as my fair market valuation of Francis Land Company on June 5, 1941. This per share. [681]

The Carson Estate Company, on the same basis of known assets which have been stipulated on June 5, 1941, amounted to \$761,396.00 as the balance of assets after liabilities and other deductions, divided by the number of shares outstanding, which were \$7,412.00, making a stipulated value per share of Carson Estate \$102.72.

This figure, I understand, has been agreed to in

(Testimony of John Gally.)

the stipulation. I was confronted with valuing the oil royalties of Carson Estate on the same basis as I valued Dominguez Estate, but knowing that the properties from which the royalties of Carson Estate were derived were rather on the side than on the top of the oil structure, I figured a poorer percentage of times earnings, which, in my estimation, I placed at 6 times 1940 earnings, which gave me \$212.52 for Carson Estate Company oil royalty valuations.

The 1940 earnings I obtained from the Government stipulation or agreed to stipulation of earnings on Carson Estate in 1940 of \$35.42. The reason I took the per share earnings in all my calculations was to simplify the figures, and they were arrived at from the simplified figures that were shown in the stipulated dollars and cents reports.

In addition to the oil royalties and the asset valuation of Carson Estate, I had to consider the value of the Dominguez stock, which was held by Carson Estate at that time, and which I figured at \$143.00 per share—I have the figures [682] here to bear me out—and the per share value of Francis stock, which I have shown above at \$947.60 gives a per share value of the Francis holdings in the Carson Estate of \$234.00, making a per share value of the total known assets of Carson Estate Company of \$692.24.

Now, to these figures I might add the speculative possibility of discovering additional oil, either in deeper sands, if the company should decide to drill

(Testimony of John Gally.)

deeper in a couple of years, or in new structures which might be developed. I know of no way of measuring this speculative value, so I have added and did not consider them in my figures.

The other method of determining market values that are practically used in our business are also the basis of earnings or the basis of dividends. However, I might say that in applying the basis of earnings, my preference would be for capitalizing the assets, plus the valuation of oil royalties as I have done, rather than stipulating the market value on earnings alone. Inasmuch as these are family holding companies they have to distribute all earnings as dividends or suffer severe tax penalties.

It is, therefore, reasonable to assume—this is my opinion—that all earnings will be distributed as dividends, so that earnings and dividends are practically the same.

Another method that I might use, in bringing to the attention of the Court in market appraisal, is that of comparison. [683] We try to take companies of a similar nature or as closely as possible in the same industry, and derive from them as to what they were selling at that time, which in this case was June 5, 1941, in the actual market. And then by making those comparisons to the stock in question I try to arrive at a basis and give that as my figure.

On the basis of these comparatives, I have found that Kern County Land, which I also obtained the figures for in Walker's Manual, and the quotations

(Testimony of John Gally.)

from the Times, I have found that on June 5, 1941, the total market valuation of Kern County Land was \$45,250,000.00, on the basis of the latest statement available, which was that for 1940. And the market value on that date showed that that figure was 14.8 times earnings.

I took another company which was a little further away from a comparison, but it is the closest I could find, which was Los Angeles Investment Company. The figures I took from the same sources, and I found that their total valuation, according to the 1940 statement, was \$2,621,590.00, which was equal to 14.9 times earnings.

Having two of these similar companies as a basis for arriving at a number of times earnings, I figured that 15 times 1940 earnings would be as close as I can get as of June 5, 1941, comparative companies with which to measure Dominguez Estate, Francis Land and Carson Estate Companies. [684]

My figures on this basis are somewhat lower and amount to \$709.05 per share for Dominguez Estate; \$779.95 per share for Francis Land; and \$531.30 for the Carson Estate Company. While I think that the latter figures are not quite as specific or reliable, they are, in my opinion, a fair appraisal of market value on the basis of earnings.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

The Witness: I, of course, have only one more

(Testimony of John Gally.)

comment to make, that in valuating securities, your Honor, I find actual sales wherever I can obtain anywhere near the period in question are always the best measure of what the actual market value is at that time. But we haven't been able to obtain these in this case, so I will have to rely on my figures obtained as I have obtained them from my three different methods of calculation.

By Mr. Melville:

Q. Mr. Gally, were you informed after you made your appraisal in this case that the parties had agreed and stipulated as to the fair market value of the oil royalties in the Carson Estate Company case at \$285,000.00? A. I have.

Q. Have you revised your appraisal accordingly?

A. I have, to this extent: That I have been confirmed [685] in my opinion in lowering the number of times earnings the oil royalties were figured at in the Carson Estate Company, as compared with the Dominguez Estate valuations. I figured 8.2 times for Dominguez and I figured only 6 times earnings for Carson royalties.

Q. On Carson royalties then at that basis, what was your total value for Carson royalties? Not per share, but total.

A. Total, yes. I am going to get that for you. Colonel Melville, I think I will have to multiply that. I see the figures here, but there are so many figures of mine to go through.

(Testimony of John Gally.)

The Court: What are your multiples?

The Witness: 6 times 35.42. I beg your pardon. 6 times \$262,528.07, which was the net income of the Carson Estate Company for 1940.

The Court: Very well. You may proceed.

By Mr. Melville:

Q. Mr. Gally, on your Carson Estate Company, with respect to your figure as to oil royalties figured on the basis of 6 times 1940 earnings,—

A. Yes.

Q. —if you were told that on the basis now of the new stipulation of facts as to two hundred eighty-five thousand for those oil royalties, it amounts to \$38.41 per share, how [686] much, if any, would that change your opinion?

A. As against thirty-five forty-two before?

Q. As against two hundred twelve fifty-two.

A. Oh, that would reduce my valuation of the oil royalties which I had figured before I had seen those stipulations by just that amount.

The Court: By the difference between two hundred twelve fifty-two and thirty-eight forty-one?

The Witness: Yes, your Honor.

By Mr. Melville:

Q. Will you carry through that computation?

A. I will. Thirty-eight forty, did you say, Colonel?

Q. Thirty-eight forty-one.

A. Thirty-eight forty-one. It is \$174.11, less

(Testimony of John Gally.)

than my figure, or instead of six hundred ninety-two twenty-four for Carson Estate, it would make my corrected figure \$518.13.

Q. Will you recheck those figures, please?

A. I will. Just a minute.

The Court: That is correct on the subtraction, as I make it.

By Mr. Melville:

Q. Now, Mr. Gally, do you consider an actual sale between a willing buyer and willing seller at a given price, does that indicate to you an indices of fair market value?

A. Absolutely. [687]

Mr. Mackay: I object to it as a leading question.

The Court: The question has been answered.

Mr. Mackay: I move it be stricken. I wish the witness to be instructed not to answer until I make my objection.

The Court: The answer may be stricken.

Mr. Melville: I will withdraw the question.

The Court: Very well.

By Mr. Melville:

Q. Mr. Gally, if a willing buyer, well and able to buy but under no compulsion to do so, and a willing seller, under no compulsion to sell but willing to do so, should make a deal whereby stock of a given company is bought and sold, would that or would it not indicate to you what the fair market value of that stock was?

A. It would be one——

(Testimony of John Gally.)

Mr. Mackay: Just a moment. I object to that as a leading question.

The Court: Well, we will hear him.

The Witness: It would be one method of arriving at a fair conclusion. I might add here, Colonel Melville, in all my experience I have found no one method that anyone can discover and say, "That is the only method," or the "only correct method of evaluating a security."

By Mr. Melville: [688]

Q. In your business what is the best method of evaluating a security?

A. I would say the best method is the actual sale, wherever it is obtainable, on that particular date. Where it is not obtainable, the next best method would be the consideration of the liquidating or book value, plus any other additional assets that might be valued for some future time ahead.

Third, the basis of number of times earnings, if it is a sufficiently seasoned security to enable one to have an active turnover of securities. And then measuring your yearly earnings against that market value of heavy turnover. This, of course, was not the case here. And, therefore, I did not use the pure earnings or pure dividend method of evaluation.

Q. Now, Mr. Gally, if you knew or if the evidence in this case establishes, before the trial is over, that there were actual sales made of Dominguez Estate Company stock at \$1,000.00 a share

(Testimony of John Gally.)

during 1941, would that change your opinion as to the fair market value of that stock?

A. It would. It would raise it to this extent: That I would allow a differential there of \$138.00 between my figure of \$861.00 of actual valuation, plus the \$138.00 to make up the \$1,000.00 asset value, and consider that \$138.00 per share as undeveloped oil or increase in possible price of oil over the next 10 or 20 years, which is very possible, or any deepening or changing of oil structures that we might discover in those [689] fields as drilling goes on.

Mr. Melville: Your witness.

Cross-Examination

By Mr. Mackay:

Q. You are not now connected with the Bank of America; are you?

A. No. I am with Fairman & Company.

Q. Fairman & Company? A. Yes, sir.

Q. You have seen the stipulation with respect to the income of Dominguez Estate Company for 1940, the earnings; haven't you? A. Yes.

Q. What figure do you use there as the earnings per share?

A. Per share I used \$47.27.

Q. Did you consider that in your valuation of the Dominguez Estate Company stock?

A. I did.

Q. If you take 8 times 1940 earnings for the value of the stock, what would that be?

(Testimony of John Gally.)

A. That would be 8 times \$496,281.00. I could multiply it here or figure it out.

Q. Isn't it 8 times forty-seven?

A. Per share? [690]

Q. That is what I am talking about.

A. Yes.

Q. That will give you 377——

A. .2. I beg your pardon. I have taken 8.2 because I obtained that figure of 8.2 by taking Dominguez oil fields as my basis for calculation, which I figured was a very close analogy.

Q. If you multiply those earnings by 8.2, what do you get? A. You get \$387.16.

Q. As the value of the stock?

A. As the value of the oil royalty portion of that stock.

Q. As the value of the oil royalty portion of that stock? A. Yes, sir.

Q. Then you took the stipulated earnings from all sources? A. Yes.

Q. As the basis for the valuation, and multiplied that by 8? A. Yes, sir.

Q. And you said that was the value of the oil royalties? A. Yes, sir.

Mr. Mackay: That is all. [691]

The Court: Let me ask the witness one question. I have here, as I recollect your testimony, three or four different figures for each block of stock, indicating the mathematical results from applying a particular yardstick. Do you, from an analysis of all these exhibits, and a consideration of all of these

(Testimony of John Gally.)

various yardsticks, have any specific amount that you would consider to be the fair market value of the stock, on the basic date, considering fair market value to mean, as no doubt what it means,—

The Witness: Yes, sir.

The Court: —the price at which the hypothetical willing buyer, having knowledge of all of the facts, and the seller, having knowledge of the facts—neither being under any compulsion—would trade? In other words, can you summarize your testimony to give me the figure for each of the shares upon which you rely or which you accept as the fair market value?

The Witness: I would take my first method that I outlined which—

The Court: Just answer the question. What are the figures you give me as your fair market value?

The Witness: I would give you \$861.46 for Dominguez Estate; \$847.60 for the Francis Land Company; and \$518.13 for the Carson Estate Company.

The Court: Very well. [692]

Mr. Melville: No more questions.

Mr. Mackay: That is all.

(Witness excused.)

Mr. Melville: Mr. Grimes, take the stand.

JOHN ALDEN GRIMES

called as a witness by and on behalf of the respondent, having been first duly sworn, was examined and testified as follows:

(Testimony of John Alden Grimes.)

Direct Examination

The Clerk: Your name for the record, please?

The Witness: John Alden Grimes.

By Mr. Melville:

Q. Mr. Grimes, will you state your educational and other qualifications?

A. I graduated in 1908 from the Minnesota School of Mines, Degree of Mining Engineer. I attended the Columbia University in New York for the next two years, taking graduate courses in geology, mining and metallurgy.

I completed all of the residence requirements for a Ph.D. degree, but stopped school to go to work for the Anaconda Copper Mining Company in their geology department in Montana, before writing many dissertations and so forth. I have no graduate degrees. I worked in the geology department of the Anaconda Copper Mining Company from July 5, 1910, until January, 1920. [693]

I entered the employ of the Bureau of Internal Revenue on January 15, 1920, as a valuation engineer and have been the valuation engineer in that organization since that time, specializing at first in the valuation of natural resource properties, principally mines, non-metallics metal deposits; later on depreciation studies under the Assistant Commissioner and Deputy Commissioner; and since 1928 in the office of the Chief Counsel of the Bureau of Internal Revenue on various valuation matters,

(Testimony of John Alden Grimes.)

principal of which have been the valuation of closely held stocks.

Q. Were you present throughout the trial of this case?

A. Yes, I have been in attendance throughout the whole trial.

Q. You heard the testimony of Mr. Wents?

A. I have.

Q. Have you made a computation to determine the percentage of yield which would result from Mr. Wents' valuation?

A. I have.

Q. What did you find out?

Mr. Mackay: I object to that, if your Honor please. It is in evidence there. We can make a computation in the brief. There is no use taking the time of the Court now.

The Court: We will hear him. He may tell. You may answer.

The Witness: 18 per cent rate of return after taxes [694] at rates in effect in 1941. And in addition to the return of the value to which Mr. Wents testified, namely, \$2,701,361.00.

Mr. Mackay: What was that?

The Witness: \$2,701,361.00.

By Mr. Melville:

Q. Do you have a chart showing this computation?

A. I have.

Q. Just what does that 18 per cent mean now?

A. That is 18 per cent interest compounded annually. That is for a seven-months period in the

(Testimony of John Alden Grimes.)

year 1941, from June 1st to December 31st, and one year additional discount for each successive year.

Mr. Melville: May I have that marked for identification?

The Court: It may be marked for identification as Respondent's Exhibit GG.

(The document referred to was marked as Respondent's Exhibit GG, for identification.)

Mr. Melville: I offer this computation in evidence as Respondent's Exhibit GG.

Mr. Mackay: If it goes in just for explanatory purposes I don't mind. As to proof of value here, I think it is objectionable. I object.

Mr. Melville: It is not intended, I also stipulate it is not intended as proof of value. We don't agree with the [695] value Mr. Wents testified to. It is simply to show that Mr. Wents' testimony would contemplate the return of about 18 per cent on one's investment after taxes and so forth.

Mr. Mackay: If it is for that purpose I object to it as incompetent, irrelevant, and immaterial.

Mr. Melville: O.K. I will withdraw it, your Honor. I don't think it makes any difference.

The Court: We will receive it for a limited purposes.

(The document referred to, heretofore marked as Respondent's Exhibit GG, for identification, was received in evidence as Respondent's Exhibit GG.)

(Testimony of John Alden Grimes.)

By Mr. Melville:

Q. Mr. Grimes, are you familiar with the facts disclosed by the stipulation? A. Yes, I am.

Q. Have you made an investigation to ascertain whether or not there was a public market for stocks of similar companies?

A. I made a very exhaustive examination of all royalty companies in which class I consider all of these three companies.

They derive their principal income from oil properties. I maintained lists of companies in different branches of industry beginning with 1928, and I have added to those from [696] time to time. In connection with this particular study I had pages of national stock summary. I turned it over page by page and got the names of all the royalty companies there. I looked all of those up in Poor's Manual or Moody's Manual, in addition to the companies for which I already had names. I compiled as complete information as I could upon the earnings, market quotations, and so forth for all oil royalty companies, stocks of which were bought and sold by the public and quoted in public records.

I found 23 oil royalty companies for which I could get both earnings and stock quotations, although two of those 23 companies I could only get preferred stock quotations, so there are 21 companies for which I could get both common and preferred stock quotations, if both classes were out-

(Testimony of John Alden Grimes.)

standing. I think those 21, though, had only common stocks outstanding.

Q. Based oupon the stipulated facts and upon your investigation of the market for stocks of similar companies, have you been able to form an opinion as to the fair market value per share of common stock of Dominguez Estate Company as at June 5, 1941?

A. I have on the basis of companies that I consider comparable to Dominguez Estate Company.

Q. What, in your opinion, was that value?

Mr. Mackay: I object to that, if your Honor please, unless he first shows what comparisons were made. [697]

The Court: Well, do I understand that that is what the witness is now going to relate, its comparative values with other companies?

The Witness: Yes. That is a statutory requirement.

Mr. Mackay: I will withdraw the objection.

By Mr. Melville:

Q. You may answer.

The Court: Very well. You may answer.

The Witness: I valued the stock of Dominguez Estate Company at \$933.31 per share as of June 5, 1941.

Mr. Mackay: Repeat that figure.

The Court: Let's have the amount again.

The Witness: \$933.31 per share.

(Testimony of John Alden Grimes.)

By Mr. Melville:

Q. Would you explain the processes by which you formed that opinion?

A. First it was necessary to ascertain what income the Dominguez Estate Company got from oil royalties. I did that by an allocation of unallocated income.

Now, there were two items of that. One was total general overhead expenses not allocated to any particular phase of the business, and the other was total taxes that were not allocated to any specific phase of the business.

The stipulated income of the Dominguez Estate Company from 1940, from all oil royalties, was sixteen hundred six ninety-four [698] before an allocated overhead and expense and capital and franchise taxes.

The unallocated general expense was \$85,507.05, and the income in other unallocated taxes amounted to \$83,896.24 in 1940.

I might explain, before proceeding further, that I consider the latest full year's income to be the best basis for comparison between one company and another. So that I have used 1940 income throughout, that being the last published figure for any of the companies available at June 5, 1941.

Now, there is very little overhead expense in my opinion in the collection of oil royalties. And practically all the company's overhead expenses should be attributed to its other activities in 1941. Those

(Testimony of John Alden Grimes.)

other activities produced only \$54,967.96 before overhead expense income and similar taxes, and that income is \$34,549.09, less than the unallocated general expense of the company. So I have allocated \$34,549.09 of this general expense against oil royalties, and I regard that as a very high figure but it simply means there was not any income from the other activities of the company with which to pay that expense. I considered it properly should be allocated to oil royalties on that account.

That means I allocated the entire taxes of the company that are not directly placed on specific items of property, those of income and franchise and capital stock taxes. I [699] allocate all of those as an expense of the oil royalty phase of the business.

With the figures I have given before, \$616,797.98 income from oil royalties, less \$83,896.24 for income and similar taxes, and less the \$34,549.09 of general expense which I have allocated to the oil royalties, I had a remaining \$498,352.65.

Now, that is the entire net income of the company for 1940, plus \$2,071.18, which the company deducted for cost depletion as shown in this stipulation. Therefore, I considered that this income of \$498,352.65 was the net income after taxes, which the company realized from oil royalties in 1940.

I have the information as to the other oil royalty companies, and I found that companies I considered reasonably similar were selling for—six oil royalty companies, whose stocks were traded in California

(Testimony of John Alden Grimes.)

markets were selling for 9.82 times their 1930 earnings, before depletion, but after taxes. I found there were six other——

The Court: Do you mean 1930 or 1940?

The Witness: 1940. I found that six other oil royalty companies with stocks traded on stock exchanges outside of California were selling for 9.67 times their 1940 earnings. Those were very close together.

Mr. Mackay: Pardon me. I didn't get that last.

The Witness: Those two ratios, the 9.82 and 9.67 were very close together. I took the lower of the two, 9.67. That only accounts for 12 of the 23 companies in the oil royalty business, for which I found published figures I regarded as sufficient to make comparisons with four companies which had rather diversified interests out of oil royalties. They had large land ownerships principally.

Since I am only valuing the oil royalties of Dominguez Estate Company on this basis, I did not take those companies with diversified activities, because that did not give me a multiplier for the oil royalties; four were eliminated for that reason. The other seven were very small, comparatively marginal companies, and I did not consider they owned as assets, or would be held in the same public esteem at all with either the Dominguez Estate or Francis, which derives its income indirectly from the same oil royalties, or Carson, which derives most of its income from the same oil royalties, plus a few additional.

(Testimony of John Alden Grimes.)

So I eliminated both the four companies which were selling on the basis of 15.96 times 1940 earnings and I have eliminated the seven which were selling on the basis of 3.72 times the 1940 earnings. I made the comparison on the basis of the other 12 companies, taking the lower of the two figures, 9.67 times earnings.

I might say I have copies of comparative information I used here. The first page is a summary and each succeeding [701] page is a detail for the one group of the four groups into which I have divided them. Then the last sheet attached to the back is a list of companies for which I could not get adequate information. That is the complete list of compaines which I examined.

By Mr. Melville:

Q. How many copies do you have?

A. I have three here. I have work sheets, too, I think.

Now, my comparisons are made on the basis of net income before depletion, but after taxes, in all cases and the four hundred ninety-eight thousand odd dollars of Dominguez income, which I have stated in my opinion came from oil royalties, was multiplied by 9.67 times earnings to value the royalties of Dominguez estate. On that basis I got a value for the royalties of \$4,810,070.13. I am carrying these out to cents, not because I believe the appraisal is anything like that accurate, but simply

(Testimony of John Alden Grimes.)

because I have other cents in the stipulated figures to add in, and make any adjustments——

Mr. Mackay: Give me that figure again.

The Court: It might be easier to keep them in the record and easier for folks to copy them down if you just threw away the cents and eliminated them altogether from the record, Mr. Grimes.

The Witness: I would be very glad to do that, because [702] appraisals are made in no such accuracy as that. It is just a method of computation, and I wanted to show the method.

The Court: I think if you just eliminate your cents, it is easier for anyone trying to copy them down, including the reporter. Let's throw the cents away.

The Witness: Those total figures I gave may not add up to dollars.

The Court: All right. We will understand.

The Witness: The stipulated value of the other assets was added to that figure to give \$9,798,769.00 for 10,499 shares of stock, or \$933.00 per share of stock.

I consider that to be an asset value simply for known assets, and I consider the company has some assets which it is impossible to value, that are too speculative and intangible, but might have a value to the owner or a possible buyer. But they are not the type of assets I would feel competent in any way to place a value on.

I might point out also that the stock prices upon which these purchases are made are the prices of

(Testimony of John Alden Grimes.)

minority interests of these companies. They are not large blocks, but minority interests that are generally traded by the public. Should I go on to the other companies? That was an asset valuation for Dominguez. I did not consider that the company, as a whole, should be valued on any earnings basis when it had practically \$5,000,000.00 of assets which, in my opinion, were [703] not producing any income at all in the aggregate.

It is obviously impossible to value any asset which is losing money on an earnings basis, and it is equally impossible to value an asset which is merely breaking even on an earnings basis, so that I saw no possibility of valuing those assets upon any earnings basis.

Since I have valued the royalties upon an earnings basis and would have to use the other assets at book value, I would get exactly the same answer on an earnings basis I would on an assets basis for the stock of Dominguez Company.

On a dividend valuation—this is personal holding company filing income tax returns as such—and it either must pay out all of its earnings as dividends, or it is going to have to pay a severe penalty tax. I, therefore, assumed the company would do the reasonable thing and pay out its earnings as dividends and that any valuation on the dividends basis would be identical with that on the earnings basis. I think that is all as regards Dominguez.

The Court: I think then we will suspend at this time. It is probably a good place to quit.

Mr. Mackay: Thank you, your Honor. I am pretty tired, myself.

The Court: We will suspend until 9:30 tomorrow morning.

(Whereupon, at 4:30 o'clock p.m., a recess was taken until 9:30 o'clock a.m., Saturday, October 13, 1945.) [704]

PROCEEDINGS

October 13, 1945, 11:00 a.m.

JOHN ALDEN GRIMES

recalled as a witness for and on behalf of the Respondent, having been previously duly sworn, was further examined and testified as follows:

Direct Examination (resumed)

By Mr. Melville:

Q. Mr. Grimes, did you finish your explanation of how you arrived at the value or your opinion of the value of the stock of the Dominguez Estate Company? A. I think so.

Q. Do you have an opinion as to the June 5, 1941 value per share of stock of the Francis Land Company? A. I have.

Q. Will you please state that opinion and how you arrived at it?

A. My opinion is that the value of a share of the Francis Land Company stock on June 5, 1941 was 1.1 times the value of a share of Dominguez

(Testimony of John Alden Grimes.)

stock on the same date. The company had current liabilities a few cents in excess of total assets, other than Dominguez stock, which I am disregarding. I am also disregarding the seven thousand a year expense, overhead expense and taxes of the Francis Land Company in arriving at that opinion. I disregard the expense of operating the company, because it was a company which, in my opinion, had [709] no useful reason for its existence in the family setup of corporations. If the stockholders chose to continue to keep this company in existence, the benefits which they derived from that or would derive from maintaining the corporate existence of the Francis Land Company would counterbalance the cost of maintaining that existence. It was a family holding company, classed as a personal holding company in tax returns, the same as Dominguez Company, which derived almost its corporate income from the Dominguez Company. It had to pay out that income in dividends or suffer penalties the same as Dominguez. So that I would value the Francis Land Company on the same basis as Dominguez as to earnings and dividends and arrive at the opinion that it should be valued according to its asset value. That, I think, is all I have to say on Francis.

The Court: You didn't give the figure. That amounts to some \$1,026.00, is that right?

The Witness: Yes, probably. I didn't write those up.

(Testimony of John Alden Grimes.)

The Court: Well, you said 1.1 times the \$933.31, is that right?

The Witness: Yes.

The Court: Very well.

By Mr. Melville:

Q. What is that, Mr. Grimes? [710]

A. Well, I should have to compute that figure in terms of——

Q. What value did you state as to Dominguez Estate Company Stock? A. \$933.31.

Q. And did you say Francis was worth 1.1 times that? A. Yes, one and one-tenth.

Q. That would make how much?

A. \$1,026.64.

Q. Now, Mr. Grimes, do you have an opinion as to the June 5, 1941 value per share of the Carson Estate Company?

A. Yes, I would simply substitute these values of the Dominguez and Francis Stock in the Carson balance sheet, and at \$933.31 for Dominguez on 1353 shares and 1785 shares of Francis at \$1,026.64, the value of all of their assets as stipulated, divide that by 7,512 shares and it gives the value per share, for the same reasons that I evaluated the stock of Francis and Dominguez on the basis of being oil royalty companies and using the stipulated figure of \$285,000.00 for the value of the royalties. That is for Carson.

The Court: I was just going to ask the calcula-

(Testimony of John Alden Grimes.)

tion. What does that bring you to? I haven't worked it up.

The Witness: I haven't either, but I will work it out. [711]

The Court: Well, we won't take time now. You may proceed.

The Witness: There is just one further observation with respect to Carson. It was operating at a loss as far as all of its assets were concerned, outside of the stocks of Francis and Dominguez and its oil royalty interests. The other assets were all producing no income, and in fact, operating at a loss, and those assets could only be valued, in my opinion, upon the basis of their stipulated fair market values.

By Mr. Melville:

Q. Now, Mr. Grimes, with respect to your opinion as to the value of the stock in each of these companies as of the basic date, I *would to* know if you gave consideration to income tax in formulating your opinions of value? A. Yes, I did.

Q. Did you give consideration in each case to the size of their holdings? A. Yes.

Q. Did you in each case give consideration to the marketability of the stock in question?

A. Yes.

Q. Did you in each case give consideration to the fact that the three companies were personal holding companies or family corporations? [712]

A. Yes.

(Testimony of John Alden Grimes.)

Q. Did you in each case consider methods other than the one you used when formulating your opinion as to the value of the oil royalties assets of the Dominguez Estate Company?

Mr. Mackay: I object to the question as leading, and if your Honor please, that has all been leading.

The Court: Overruled. Let him answer.

A. Yes, we consider other methods.

By Mr. Melville:

Q. Did you consider the payout method?

A. Yes.

Q. Did you consider percentage of volume?

A. Yes.

Q. Did you consider the daily barrel method?

A. Yes.

Q. Does the daily barrel method have an appropriate application in this case, in your opinion?

A. No.

Q. Why?

A. The daily barrel method is a very elastic yardstick. It was used in the early days of the oil industry, and would apply principally to the valuation of an individual oil well, computing an interest in that or computing the whole oil well, and the price would vary considerably. I [713] believe Mr. Paine's book gives a range of 400 to 2500 dollars per barrel of daily production, which is a very elastic yardstick. Applying it between properties with a great number of wells or properties in different states of development, I don't

(Testimony of John Alden Grimes.)

believe it is applicable at all. It is not applicable for another reason, that if a property is capable of producing a thousand barrels a day, but by curtailment it only produces 500 barrels a day, this daily barrel production business obviously does not apply to such an oil well.

Now, if you have a property which is fully developed and in which production is going to decline in the future, you would get a yardstick there which would be impossible to apply to another property which had new sites to drill wells and from which an increase in production rather than a decrease could be expected in the immediate future years.

Particularly with respect to curtailment, you could not use the yardstick of price per barrel of daily production from a pumping well and apply that to a flowing well, because it is my understanding that there was no curtailment of production with respect to pumping wells and there was curtailment of production with respect to flowing wells, that all of the curtailment of production which was in effect applied simply to flowing wells.

Q. Did you consider the present worth method when evaluating the oil royalties of Dominguez Estate Company? [714] A. Yes, I did.

Q. Did you consider the sales of comparable royalty interests in reaching your opinion as to the value of the oil royalties in the Dominguez Estate Company?

Mr. Mackay: I object to that, if your Honor

(Testimony of John Alden Grimes.)

please, unless they specify what the comparisons are based upon. It is a leading question.

The Court: The question was rather general, don't you think, Mr. Melville?

Mr. Melville: Perhaps so, your Honor.

The Witness: I think I could answer that in a way which would not embarrass Mr. Mackay at all.

Mr. Mackay: It is not a question of embarrassing Mr. Mackay. It is a question of competency. Has the Court ruled on that?

The Court: I understand so. I thought I had. Perhaps Mr. Melville was going to rephrase his question.

Mr. Melville: I will attempt to do so, your Honor.

The Court: Very well.

By Mr. Melville:

Q. Do you have knowledge, Mr. Grimes, of any specific sales of oil royalty interests in the Los Angeles area at or about 1941?

A. The only sale that I was able to find was a sale of [715] a large royalty interest—for at least five years prior to June 5, 1941—a Grubb sale of royalties and the Taylor lease to the Shell Company, concerning which Mr. Pemberton already has testified.

Q. Did you inquire into the facts with respect to that sale? A. Yes.

Q. And did you consider that sale in forming your opinion as to the fair market value of the

(Testimony of John Alden Grimes.)

oil royalty interests of the Dominguez Estate Company?

Mr. Mackay: I object to that as speculative.

The Court: Overruled.

A. No, I did not consider that sale directly, because as Mr. Pemberton testified, the sale was made in order to pay estate taxes, and they had a choice of selling something and they chose to sell the oil royalties, and I considered there was some element of a forced sale in that transaction.

By Mr. Melville:

Q. Mr. Grimes, which is worth more, a lessor's interest in oil in the ground or the lessee's interest?

A. In my opinion, the lessor's interest is worth more than the lessee's interest in any property. The lessor has the first claim upon the income from the property. In an oil property, to be specific, the lessee pays all the cost of drilling the wells and bring the oil to the surface. [716] When he gets it to the surface he delivers a certain percentage of the total production, in the customary lease, to the lessor, without cost to the lessor. The lessee takes all of the risks. Now, if you compare the lessor and lessee interest in an oil property to a corporation, the lessor's interest, in my opinion, corresponds to the first mortgage bond of a corporation and the lessee's interests corresponds to the common stock.

Q. Mr. Grimes, are you familiar from your studies with the general market conditions as re-

(Testimony of John Alden Grimes.)

vealed by Dow Jones Averages and other analyses of the securities market in 1924?

A. Well, I know during 1924 we were having a severe—just emerging from a severe depression, and I know that at times during that depression that securities of very important companies were selling for substantially the book value of the net current assets, which would include bonds, preferred stocks and majority common stocks, in most cases. That is, if you could have bought all the securities of the company at the quoted market price, you could have bought those securities substantially for the book value of the net current assets of a number of large companies. The United States Steel Corporation at the bottom of the depression was one such company.

Q. Mr. Grimes, will you state, if you know, what the general market conditions were in 1938? [717]

A. I know there was a very precipitous decline in stock market prices during some part of 1938, as shown by the Dow Jones Averages. I believe it was the most precipitous decline in the stock market not excepting the 1929 crash.

Mr. Melville: I ask that this be marked for identification, your Honor.

The Court: Describe briefly for the record, please, what it is you are having the Clerk mark for identification.

Mr. Melville: It is tabulations on various sheets which represent Mr. Grimes' work done in support of his testimony and an explanation thereof.

(Testimony of John Alden Grimes.)

I will have him further identify it after it has been marked, if your Honor please.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record then. The document which has been handed to the Clerk is now being marked for identification as Respondent's Exhibit HH and has now been handed to counsel for the Petitioner.

(The document referred to was marked as Respondent's Exhibit HH, for identification.)

Mr. Melville: I gave him a copy yesterday, your Honor, when Mr. Grimes started his testimony.

The Court: Very well. There being no objection, the document may be received. [718]

Mr. Mackay: If your Honor please, I would like to make this observation, that I understand this is not being offered in evidence as evidence of the value, but merely explaining the method, if my understanding be correct.

Mr. Melville: I will have the witness identify the document and explain what it is.

Mr. Mackay: I would like to be sure that the Court struck that out then.

The Court: Well, I will set aside my observation that the document was received in evidence. Now, you have some query you wish to make, Mr. Mackay?

Mr. Mackay: Yes. I said that I had no par-

(Testimony of John Alden Grimes.)

ticular objection to it if it is merely going in there to show computations, but if it is in evidence of value, I do object to it as incompetent, irrelevant and immaterial.

The Court: What do you say?

By Mr. Melville:

Q. Mr. Grimes, what does the document purport to be?

A. This is the detailed information obtained from Poor's and Moody's manuals and various sources of stock quotations which I believe are all mentioned on the sheets, for the 23 oil companies for which I was able to get published information. It classifies those companies into four groups, which I have already explained, and shows the average capitalization rates for each group, and it shows the detailed [719] sheet, each company in this group, with earnings, published earnings, published dividend figures and computations which I used in arriving at the capitalization rate of 9.66.

The Court: If I understand, Mr. Mackay correctly, he has only asked this—the witness has testified that he used certain figures, and Mr. Mackay is suggesting that we receive the exhibit itself not as proof of the facts occurring in the exhibit, but merely as data which the witness assembled for the purpose of making his computation, and I understand that is all you are offering it for, is that correct?

Mr. Melville: That is right, your Honor, not as evidence of value, but as supporting data back of Mr. Grimes' method of appraisal.

(Testimony of John Alden Grimes.)

The Court: Does that answer your question, Mr. Mackay?

Mr. Mackay: Well, not quite, your Honor. I must confess that with all the work I have had I didn't go over this a great deal. May I ask the witness one of two questions?

Mr. Melville: Certainly.

The Court: You may.

Mr. Mackay: Are these companies you have referred to, are their stocks all on the New York Exchange or Los Angeles Stock Exchange?

A. No, sir, the only company on the New York Stock [720] Exchange is the Texas Pacific Land Trust. There are several on the New York Curb Exchange, and there are one or two on Los Angeles.

Mr. Mackay: Just a moment now. How about these? Let's start with the first oil company lease in California, Merchants Petroleum Company, is that on the Los Angeles Exchange? Is it listed?

The Witness: That is my information.

Mr. Mackay: Do you know whether it is listed?

The Witness: It is traded on the Exchange. I wouldn't say whether it is listed on unlisted stock.

Mr. Mackay: You don't know if it is listed, do you?

The Witness: No.

Mr. Mackay: What about the M.J.M. & M. Consolidated?

The Witness: San Francisco Exchange. I wouldn't say whether it is listed or unlisted.

Mr. Mackay: What about the Mt. Diablo Oil,

(Testimony of John Alden Grimes.)

Mining & Development Company? Los Angeles?

The Witness: Los Angeles traded.

Mr. Mackay: You don't know whether it is listed?

The Witness: No.

Mr. Mackay: San Gabriel River Improvement Company?

The Witness: Over-the-counter.

Mr. Mackay: No listing? [721]

The Witness: It had been listed until August 1st, 1940, and then was withdrawn from listing with permission of the S.E.C.

Mr. Mackay: I am asking about that and you don't know. How about the United States Petroleum Company? Is that listed?

The Witness: Traded on the San Francisco Exchange.

Mr. Mackay: But not listed?

The Witness: I don't know whether it is listed or not.

Mr. Mackay: Well, if your Honor please, if it is just put in there as merely explanatory of his testimony, then I have no objection.

The Court: Very well. It will be received as Respondent's Exhibit HH.

(The document referred to, heretofore marked as Respondent's Exhibit HH, for identification, was received in evidence as Respondent's Exhibit HH.)

Mr. Melville: You may cross examine.

(Testimony of John Alden Grimes.)

Cross Examination

By Mr. Mackay:

Q. Mr. Grimes, I understood you to say that you are at the present time connected with the Government of the United States?

A. I am an employee of the Bureau of Internal Revenue. [722]

Q. And you are, at the present time, are you not, assigned to the general counsel's office?

A. Chief counsel's office.

Q. I mean chief counsel's office, if you want to correct me.

A. Yes.

Q. How long have you been assigned to that position?

A. My recollection is since about March 1st, 1928.

Q. And you were assigned there for the purpose of sustaining values that the Commissioner had determined in issues pending before The Tax Court?

A. No, indeed.

Q. You work with trial lawyers in trying to sustain their values, don't you?

A. No, I work to try to find the right values, and possibly four out of five of the cases I consider are settled out of court without any trial.

Q. I know, but you are assigned to the trial attorneys who have the cases?

A. I work with the trial attorneys on any valuation cases that have been assigned to me for going to trial when I think that the government's position is right.

(Testimony of John Alden Grimes.)

Q. That is right, and you select the witnesses to help you on that, don't you?

A. I assist the attorney in selecting the witnesses. [723]

Q. Now, have you had any experience in—you are not a petroleum engineer, are you?

A. I wouldn't claim to be. I have had very slight experience with oil properties.

Q. Most of your work has been confined to mining?

A. Well, before I went in the government service it was principally mining, and some very slight oil experience.

Q. But you don't hold yourself out as a petroleum engineer?

A. No, I wouldn't think of doing so.

Q. Now, you keep a lot of statistics, don't you, Mr. Grimes?

A. Will you repeat that question?

Q. You maintain a lot of statistics, don't you, for the purpose of trying to check the values claimed by the taxpayers?

A. Well, I think I can answer that yes. I probably have individual folders on 1500 companies in the various lines of industry, that most of them have the summary and the entire published corporate history of that company, as to earnings, dividends, balance sheets, et cetera.

Q. And it is from there, those statistics, that you

(Testimony of John Alden (trimes.)

generally form your opinion as to value, isn't it, Mr. Grimes? A. No, indeed. [724]

Q. You don't use them in doing that?

A. Oh, I use them in doing it, but in forming an opinion of value, I follow a very definite procedure. I try to find the companies which are as comparable as possible with the one being valued. Now, in any industry you can find at any time almost a two for one difference in rates of capitalization. I try to pick the most comparable companies out of that industry in one manner or another. I consider size, I consider rate of growth, growth of earnings, I consider many things, and I narrow the comparison down to what I consider to be the most comparable companies in that industry, and then I try to form an opinion as to whether the company to be valued is better or worse than the comparatives I have, all of which is a matter of judgment based upon statistics, but I do use statistics, but I also try to use judgment.

Q. The whole success of your valuation depends upon your ability to select the comparatives, is that right?

A. Yes, for the sole purpose of ascertaining as nearly as I can what is the market for comparable property.

Q. And, of course, those statistics cover the whole United States, isn't that right, in a general way, I mean? A. Oh, yes, generally.

Q. So that when you are called upon to make a

(Testimony of John Alden Grimes.)

valuation you do not go up to the oil field and make an investigation, [725] do you?

A. No, it would be useless for me to go to the oil field to make an examination. What can you find out at the oil field is entirely a matter of record. No one has ever been underground in an oil field. They just have to take the records that are available.

Q. Maybe with the atom bomb we can go underground. A. Maybe.

Q. Now, I think yesterday, Mr. Grimes, you stated that you had made some computations which showed that based upon Mr. Paine's report or his testimony, that there would be a return of 18 per cent compounded annually, did I understand you to say correctly? A. That is right.

Q. What figure did you use to determine that 18 per cent?

A. I don't understand your question, I am afraid.

Q. How did you arrive at that 18 per cent?

A. I took the stipulated probable royalties——

Q. In barrels? A. No, no, in dollars.

Q. Okay.

A. I can't get compound interest on barrels of oil.

Q. I agree with you.

A. From that figure I deducted probable income taxes. [726] Those taxes were determined in accordance with the rates existing in 1941. I think the

(Testimony of John Alden Grimes.)

explanation of that is down here at the bottom of this.

Q. Can you tell without reading it?

A. Well, I can tell in a general way. The California Act had some provisions in it with respect to depletion and which the Federal tax laws had at that time. That was the 1939 Act. California charged four per cent tax on net income after depletion: I took depletion to an owner at 27½ per cent. Now, I could have used depletion to a buyer of the property, taking cost depletion, which would have given me a higher amount of depletion and less tax. I chose the lower of the two figures, deducting those estimated taxes—I didn't finish the federal tax on it. I used 22.1 income tax plus 20 per cent of that tax added for defense tax. That as of June 5, 1941 I should have regarded as a temporary measure, but I took it all the way through the life of the properties. Now, deducting the taxes from the stipulated probable royalties, gives a probable net royalty income for each year. From that net royalty income I deducted 18 per cent in 1941 for a seven month period of time, 18 per cent annual interest for that period of time on the value which Mr. Wentz testified to as of June 5, 1941. I took the full month of June, because the royalties for June would not be received until the end of the month, would not have begun in [727] the first five days, during those five days. That deduction of that amount of interest from Mr. Wentz' values left a certain amount available for capital retirement, so

(Testimony of John Alden Grimes.)

I reduced Mr. Wentz' original figure of \$2,701,361.00 by the amount of income available for capital retirement in 1941. I proceeded year by year on the same basis, taking 18 per cent on the remaining capital, that is, the capital at the beginning of the year. I first charged against income for each year, completing the balance of reduction of capital—I continued that on to the 1965 figures, in order to make that complete retirement of 18 per cent. I did that because we had \$296,000.00 of net royalty income after taxes, according to my computation, that had been received at the rate of \$55,000.00 in 1965, at the rate of \$61,000.00 in 1964, declining at the rate of about six thousand a year. I continued that decline for the next four years from 1966 to 1969, in order to retire the full amount of capital. The value of such income at 18 per cent that long after 1941 is very, very low. For 1968, for example, a dollar of income would be worth less than a cent.

Q. Now, Mr. Grimes, you spoke about the 18 per cent. Do you mean that it is 18 per cent of the unamortized capital? A. Yes.

Q. And how long, under your computation there, would it take the purchaser, based upon your computation, to recover [728] his capital and put it in his pocket so that Uncle Sam would not have hold of it?

A. Strictly according to this computation?

Q. Yes.

A. It requires the whole life of the property.

Q. I see. That is based upon the assumption

(Testimony of John Alden Grimes.)

that an investor would not get back his capital until 1965?

A. Well, in this computation there were a couple of thousand dollars that were not retired at the end of 1965, and it would take about four years more to retire those.

Q. I see. Now, Mr. Grimes, you say you used, I think your figures show a 19 per cent income tax rate?

A. No. I deducted 19.82 per cent of the gross royalties before depletion. That represents a much higher income tax rate after depletion.

Q. Well, what was your income tax rate? Did you say 22 per cent?

A. Yes, I used 22.1 per cent income tax and I used 10 per cent of that, which would be 2.21 per cent additional, of the taxable income, for defense taxes, and four per cent California corporation tax.

Q. That was the 1940 rate, was it, Mr. Grimes?

A. Yes.

Q. I understood you to say that in determining the fair market value of the probable future income, you did also [729] give consideration to the probable future taxes?

A. Are we on Mr. Wents' computation or on something else?

Q. No, I am just asking you now.

A. In this computation or in some other?

Q. No, in the method your have used.

A. With Mr. Wents', yes, I took off taxes.

Q. Now, Mr. Grimes, you were familiar with

(Testimony of John Alden Grimes.)

stock market conditions, weren't you, in 1941 to June 5, 1941?

A. Well, in a general way. I can't claim familiarity.

Q. No, you are not a broker and you don't have to keep track of all those cases, but you do have an opinion as to them, don't you?

A. Yes.

Q. You keep pretty well up on the trend of taxes, don't you, as statistician and expert for the government?

A. No, I can't say I do. My work is usually about five years behind the current taxes when it gets into court.

Q. I know that. I will withdraw that. What would happen to this computation, Mr. Grimes, that you have here, if, instead of using a 22 per cent less ten per cent more for defense tax, you used the actual rates in 1933, which I believe would amount to something like 33 per cent. I mean 1941.

A. 1941? [730]

Q. Yes. A. Well, I am not——

Q. You are not prepared to say?

A. ——prepared to say what it would be, but the computation would be modified.

Q. Very substantially, wouldn't it?

A. No, I wouldn't say substantially. The computation would be modified by the amount of the difference in taxes, and almost in direct proportion to the—well, I will go further than that. It would be modified in direct proportion to the net royalty

(Testimony of John Alden Grimes.)

income which you would have after the deduction of taxes.

Q. As a matter of fact, if it were demonstrated that by using the 1941 rates instead of having 18 per cent on your unamortized capital that you wound up with 10 per cent, would that change your opinion?

A. Well, I am not aware that the rates of the taxes were changed by June 5, 1941.

Q. I asked the question, would that change your opinion?

Mr. Melville: At this time, your Honor, I wish to ask counsel if it is in the record that this is Mr. Grimes' opinion or is this Mr. Wents' opinion?

The Court: Well, I presume the question is intelligible to the witness. Do you understand the question, Mr. [731] Grimes?

The Witness: I think I do. Mr. Mackay is asking me about 1941 taxes rates. I don't believe there was any change in the 1940 tax rates before June 5, 1941. If any change came about at a subsequent time, I would not apply the subsequent time to a valuation at June 5.

The Court: His question, as I understood it, Mr. Grimes, was, if you, instead of taking the percentage of 19.82 which you arrived at as shown in the Footnote B of this document which has been received as Respondent's Exhibit GG, if you would not obtain a substantially different answer if, instead of taking that factor, you had taken a factor equivalent to the tax rate which gave no consideration to the

(Testimony of John Alden Grimes.)

depletion, you would have gotten a larger return. Is that the substance of your question, Mr. Mackay?

Mr. Mackay: Except with respect to depletion. I merely meant to say this, if by using the same figures you used now when you took the 1940 rate, Mr. Grimes? A. Yes.

Q. Now, if by applying 1941 rates in the same method you have applied them here, it would show that the interest on the unamortized capital would be not 18 per cent, but 10 per cent, would that change your opinion as to the fair market value of the royalty?

A. Well, I still don't understand that question, [732] because in this computation I am not expressing any opinion about the fair market value of those royalties. This is Mr. Wentz' opinion. I am simply stating with such a value as he testified to with such taxes, there would be an 18 per cent return. Now, if the tax rates different from Wentz' were used, there would be some other rate of return. If they were higher than the ones I used, it would be a lower rate of return. If the taxes were lower than the ones I used, you would get a higher rate of return.

Q. That is right. It is a fact, Mr. Grimes, that the higher the taxes, particularly the higher the taxes on future income, the less the value would be, isn't that a fact?

A. Why, yes. I think that is self-evident.

Q. Now, when you came to an opinion as to

(Testimony of John Alden Grimes.)

the fair market value of a royalty, what tax rate did you use?

A. I used the actual taxes paid by the company. I was basing my comparisons upon 1940 income, therefore, that was the last published income which was available for comparative purposes of the companies whose stocks are listed or sold, and I compared the income of the Dominguez for the same period in making the comparison. Now, the price figures of the stocks for 1941 in themselves would reflect any tax changes before 1940 and 1941, in the stock prices.

Q. Do I understand then, Mr. Grimes, that in arriving at your opinion as to the fair market value of the oil [733] royalties, that you did not take into consideration the 1941 tax rates?

A. You mean of the Dominguez Estate Company's royalties?

Q. Yes.

A. No, I used the actual taxes the company paid. I used the actual instead of a merely theoretical computation.

The Court: Why do you show the actual?

The Witness: There was a certain amount of overhead expense——

The Court: I am asking you where do you show the actual taxes paid in this exhibit? Exhibit GG?

The Witness: I thought we had proceeded beyond that.

The Court: Have you? Well, maybe I was wrong.

(Testimony of John Alden Grimes.)

The Witness: No, this has nothing to do with the computation.

The Court: I didn't understand the reference to using actual taxes.

Mr. Mackay: No, I think that is a pertinent suggestion. I wish the witness would so answer it.

The Witness: In explanation of my valuation of the Dominguez Estate Company royalties yesterday, there were certain unallocated general expenses of the company which must be allocated, insofar as income was available from the assets for the values which had been stipulated. I allocated [734] those expenses to obtain a valid valuation which could be supported. Now, they represent about thirty-five thousand, if my recollection is correct, which the income from all the other assets of the company would not cover, and I allocated the entire remainder of that overhead expense to oil royalties, although I consider that was too high an amount of overhead expense to be allocated to the oil royalties, on account of leaving no profit and no loss from the assets for which values were separated, and attributed all the income tax paid by the company in 1940 to the oil royalties, and I deducted the full income, franchise and capital stock taxes paid out of only the oil royalties in making my valuation.

By Mr. Mackay:

Q. Now, Mr. Grimes, our problem here, isn't it to value future income, probable income, which

(Testimony of John Alden Grimes.)

begins on June 5, 1941 and extends to 1965? That is right, isn't it?

A. For the oil royalties?

Q. Yes. A. Yes.

Q. Now, in order to arrive at a value of that, we must necessarily take into consideration the amount of money that is going to finally come back into the investor's hands, the tax part and everything else, isn't that so? In my opinion it is the tax or any other income to the investor which determines the value. [735]

A. I don't think any investor would pay anything for the right to pay future taxes.

Q. Did you write a book?

A. Yes, I did.

Q. I think it is a good book, Mr. Grimes.

A. Thank you.

Q. On Page 99 I want to call your attention to just one item here: "The imposition of an income tax serves not only to reduce the amount of future income which the investor retains from the yield of the income producing property, but also to reduce the net earnings of sinking funds set aside to cover the return of the initial investments." You are still of that same opinion, aren't you?

A. Yes.

Q. And I will read you also another one here, where you said that: "But when depreciation or other deductions in the nature of a capital return operate to reduce the income subject to tax, and the price which an investor is willing to pay for a prop-

(Testimony of John Alden Grimes.)

erty is considered as determined on the choice of a future net yield after the payment of the tax on income and proper provision for the return of capital, the problem is more complex, as the value sought depends upon the amount of future tax." You still maintain that same view as expressed in that? A. Yes, I do. [736]

Q. Yes. All right. Then why, in valuing these royalties, did you not take into consideration the knowledge that there would be as a charge against this future income very substantially increased taxes?

A. My method of valuation did not require any theoretical consideration of what taxes would be. The companies wanted to make comparisons of the paid income tax in 1940, as paid by the Dominguez Estate Company.

Q. Yes.

A. Now, I compared market prices for those companies at June 5, 1941, arriving at my opinion of the value of the Dominguez Estate Company. Now, any change in the prospects for future taxation would be reflected in those market prices for the stocks of comparable companies, based upon what taxes they had paid in 1940.

Q. Now, you are familiar with the fact that before May of 1941 hearings had been held before the Ways and Means Committee for the purpose of greatly increasing the tax return?

A. Well, I am not familiar with that, but I assume that tax hearings started before that date.

(Testimony of John Alden Grimes.)

Q. I would like to call your attention to the federal income tax service. This is Prentice-Hall—you are familiar with Prentice-Hall, aren't you?

A. Yes, they published my book. [737]

Q. Here it speaks, referring to July of 1941: "During the first days of the Ways and Means Committee hearings, the primary subject is the proposals for new taxes. From the beginning the outstanding argument is on the question of how much taxes will be increased on individual incomes of less than \$2,000.00. They are planning to double and even triple those taxes, in many instances. The only certainty at the present is that practically all existing taxes will be greatly increased and that many new ones will be imposed, but the exact rates are far from being settled."

Now, I think you referred also to Moody. I think that is a reputable stock reporting service, isn't it?

A. Yes, very reputable.

Q. On May 5, 1941—I am reading from volume 33, number 18. "Sagging prices without any heavy liquidation were seen in last week's stock market. Many stocks touched new lows. No startling news accompanied this market reaction, which seems to be due partly to war conditions involving visions of higher taxes. It has been almost universally expected that the normal taxes of corporations would be increased from 24 per cent to 30 per cent; in fact, many corporations included the rate of 30 per cent in their reports for the first quarter. It was proposed that this increase could be accom-

(Testimony of John Alden Grimes.)

plished by imposing a surtax of six per cent on top of the normal tax of 24 per cent.” [738]

I would like to call your attention also to the Moody's of May 12, 1941: “We see no satisfactory signs of the old prices continuing, or going up in consistent fashion. The background still remains one of uncertainty about America's position in the war or the extent peace time production will have to give way to armament production or ideas of taxation. The atmosphere needs some clarification before stock markets can turn around even temporarily.”

I would also like to call your attention to one more——

Mr. Melville: Let me ask you a question, Mr. Mackay: Suppose the editors wrote those things? So far as I know, he has used the facts and figures that we agreed to go in without objection.

Mr. Mackay: Well, these are the reports you said I could refer to in your stipulation. Do you have any objection to them now?

Mr. Melville: Yes, I think it is a simple editorial that tried to analyze what is going to happen, and what someone said in these editorials, isn't anything but hearsay. I think this matter ought to be stricken out, your Honor.

Mr. Mackay: Well, if your Honor please, here is a man who is holding himself out as an expert and supposed to know—— [739]

Mr. Melville: He isn't responsible for what these people say.

(Testimony of John Alden Grimes.)

Mr. Mackay: He isn't responsible for what they say, but he ought to know what they say, if he has plans to talk as an expert. He, himself, referred to that in his direct examination, and I might state, too, your Honor, that at counsel's request I gladly put in the stipulation that witness could be referred to these various Moody's and Poor's and what not. Now, just because it hurts counsel a little, he is trying to object to the understanding.

Mr. Melville: No, your Honor.

The Court: Well, I think that the procedure has developed to this extent, that if you have some interrogation that you are making of the witness and calling his attention to some editorial or something, that is one thing, but standing up and reading into the record a bunch of editorials without tying it in with anything, without making it part of a question, just rather encumbers the record, because if you are going to adopt that method of putting in that sort of statement, I am going to rule it won't go in for any purpose.

Mr. Mackay: I appreciate that, your Honor. I will state to the Court I have only one or two more of these that I want to call to his attention and then ask him——

Mr. Melville: Your Honor, I am going to object.

Mr. Mackay: I am going to ask if he is familiar [740] with them, and if he doesn't know that situation was that, in fact.

Mr. Melville: Even assuming that it be the situation, I fail to see the materiality, your Honor, of

(Testimony of John Alden Grimes.)

that, and move to strike out the editorials that have been read into the record.

The Court: We won't strike them, but—I am only speaking as the judge presiding at this trial. I don't particularly care to have you read me a lot of editorials, unless you are assuming to ask some question in reference to what you are putting in; I can't think of any other reason for that at all.

Mr. Mackay: If your Honor please, I will re-frame the question.

By Mr. Mackay:

Q. I will ask you, Mr. Grimes, whether you are familiar with the report of the Moody stock service dated June 2, 1941, which said, in effect, that earnings would be smaller, that net earnings after taxes might decline somewhat further? [741]

A. No, I don't think I need to be familiar with that. The stock market has to take into consideration all these services and comments by anyone, not only by Moody, but by everybody who is making them.

Q. Well, you wouldn't say that the stock market at the end of 1940 had taken into consideration the tax imposed in July, for instance, 1941?

A. No, I haven't said any such thing. I say the stock market of June 5, 1941 is the basis for my comparisons, and the stock market is very sensitive to those expected future changes.

Q. All right, how far do you think the stock

(Testimony of John Alden Grimes.)

market reflected at the end of 1940 when you were checking the data the excess profits tax of 95 per cent?

A. Well, your question is not correct. I am not taking my data on stock prices at the end of 1940. I assume an earnings for 1940. Now, those earnings are not going to change a bit. You determine the value by what the stock market is paying for them on the basis of the year's' earnings. Usually, I think the factor I used was 9.67. Now, if I had used some other time of the year when there was less anticipation of future taxes, it might have been $10\frac{1}{2}$ times or 11. If I had used the picture at some other time when there was much greater anticipation of future taxes or lower income for immediate future years, whether it was 1941 or any other time, [742] that might have been 8 times earnings. At June 5, 1941, the stock market was about 9.67 times the 1940 earnings.

Q. Now, Mr. Grimes, I am not disputing the fact that the 1940 earnings that you were using would show certain values. I am merely asking you in valuing the future income here, in valuing the oil royalties, I should say, why you didn't take into consideration the contemplated and proposed increased taxes?

A. I did take that into consideration in that 9.67. That is the value per dollar of earnings that I used. That was the stock market's discounting of what those future taxes meant.

Q. Now, I am trying to find out how far—you

(Testimony of John Alden Grimes.)

see, we are trying to put values on estimated probable production of barrels of oil up to 1965. Now, in your opinion, how far in advance did the 1940 earnings of those companies that you have used as a basis reflect the increased taxes which could have easily been foreseen at the basic date?

A. Well, that is going to be a very difficult question to answer, Mr. Mackay, because we would have to go into what changes could be expected in the other current figures, and we have stipulated current figures throughout. Now, if you expect a change in one factor, you have to expect changes in others.

Q. Didn't the stock market, Mr. Grimes, in 1941, June 5—it was pretty well down at that time, wasn't it? [743]

A. Well, all I know is it was going up between June 1st and June 5th. It had gone up some.

Q. What were the Dow-Jones averages on June 1st?

A. Now, I can't carry those figures in my head.

Q. What were the Dow-Jones averages on June 5th?

A. I can't carry those figures in my head.

Q. How did you know they were going up?

A. I know the stocks owned by the Dominguez Estate were value at \$8,000.00 less on June 1st than they were on June 5th.

Q. Of course, you are taking about the securities they held? A. Yes.

Q. That is how you arrived at that. I under-

(Testimony of John Alden Grimes.)

stood you to say it would be quite difficult to take into consideration the probable income tax, possible future income tax, is that right?

A. No, I think I have taken that into consideration. If you mean for any one individual to appraise what the future held in store. I think that is impossible. The appraisement I have used in the consensus of opinion as reflected in the stock market.

Q. Now, Mr. Grimes, is it any more difficult in your opinion as a supposed expert to try to tell the Court what the value of probable income to be derived from probable production [744] of oil 25 years hence than to forecast some estimation of what tax will be collected upon that income?

A. No, they are both predictions. We have agreed upon one of those, however, and it is much easier for me to do that than to make independent predictions or accept somebody else's independent prediction of some other factor.

Q. Now, Mr. Grimes, may I ask you, did you make an analytic appraisal to determine the present worth of those anticipated royalties?

A. I made quite a number of them.

Q. Well, I don't want them all. Did you make any recent one? What was your present worth figure?

A. Oh, I didn't value them that way. I valued them by various rates of interest from 4 to 10 per cent, as simply a computation, and I valued them both on the basis of the owner who was taking 27½, I believe, and I valued them on the basis of the

(Testimony of John Alden Grimes.)

average earning and interest and depletion, and by general figures that would be returned after taxes, at an arbitrary 25 per cent rate on taxable income.

Q. You mean to say that you just arbitrarily assumed that that income to be expected in the future would be subject to a 25 per cent rate only?

A. I just made those figures——

Q. Now, answer that question, please.

A. I just took a flat 25 per cent rate for the purpose [745] of making those computations.

Q. I see. Well, what was it, for an individual buyer or was it for a corporation?

A. I could not make any computations for an individual buyer. They had to be for a corporation. Individual buyers would have to many different tax rates to——

Q. Well, now, will you please refer to Exhibit K-1, I think, and also to the stipulation. Now, I want to call your attention at this time, Mr. Grimes, to joint Exhibit 11-K(2). A. Yes, sir.

Q. I think that that shows that the total estimated probable income for 1941 would be \$412,652.00, right? A. Yes, sir.

Q. 27½ per cent of it would be a change for depletion, wouldn't it, of that? A. Yes.

Q. And how much would that leave which would be taxable? A. 72½ per cent of that.

Q. 72½ per cent of that amount, amounting to more than \$300,000.00, wouldn't it?

(Testimony of John Alden Grimes.)

A. You are talking now about the Dominguez Company?

Q. Yes.

A. Yes, because there would be a difference if a buyer bought these royalties and paid a higher price. [746]

Q. I understand, but I am speaking now that you are entitled to a 27½ per cent set-off because of depletion. A. Yes.

Q. All right. Now, therefore, that purchaser, if he used percentage depletion, would have an excess of \$300,000.00 taxable income; wouldn't he?

A. That is right.

Q. And the rate in 1940 would place him in what bracket? Isn't it about 60 per cent?

A. The Dominguez Company—

Q. I am talking about an individual.

A. Oh, I haven't any idea where it would bring an individual.

Q. Well, I will show you a table of rates for the year 1940. The rate for 1940 put him in a bracket there of over \$300,000.00, of 60.81, wouldn't it?

A. If he had no other income but this it would, but admit at that time there were people that were going out and purchasing companies that lost money in order to get lower tax brackets, so we have got to have all of your circumstances of a particular individual in order to see what the ownership of royalties of this kind would mean to him. You can't just assume that this was his whole income, so if

(Testimony of John Alden Grimes.)

you are going to get any individual to purchase it, they would not be able to purchase it as advantageously as a corporation. [747]

The Court: I suggest that questions be answered directly where it is possible to do so.

Mr. Mackay: Thank you, your Honor.

By Mr. Mackay:

Q. Now, after the 1940 tax the rates began at .44 per cent on the first \$2,000.00 and went to 60.81 at \$300,000.00, didn't it? A. Yes.

Q. Have you any idea what the tax on that \$300,000.00 of income would have been in 1941?

A. For a single individual?

Q. For a single individual A. No, sir.

Q. It would have been over \$183,000.00, wouldn't it, Mr. Witness? A. Not necessarily.

Q. Well, assuming that that is all the income the individual had, and that was his net income.

A. Yes, with those assumptions you are correct.

Q. Yes, all right. Now, if you apply the 1941 tax rates, the tax would have been greatly increased, wouldn't it? A. To this individual?

Q. Yes. A. I am sure that it would.

Q. Now, in your opinion could not the increase in income [748] taxes be as well foreseen as whether this oil would come out of the ground or not?

A. Well, I have tried to explain that.

Q. I will withdraw the question. Now, assuming that a corporation had purchased that?

A. Yes.

(Testimony of John Alden Grimes.)

Q. And what figure did you say was your figure for the oil royalties fair market value?

A. All your royalties, you mean?

Q. Yes. \$4,819,007.00.

Q. Well, call that approximately \$4,800,000.00. Now, let's assume that a corporation had bought that at that time, Mr. Grimes, and that it had received the income in 1941 for the value supported by the estimated probable income? A. Yes.

Q. What would have been its fair tax?

A. I don't know what his tax would have been. The rates undoubtedly were changed after June 5, 1941.

Q. Well, under the 1940 rates what would it have been?

A. I would say about 20 per cent.

Q. Well, what would have been the net income of the company, presuming that to be its net income?

A. I will have to give you approximate figures.

Q. That is all I want. [749]

A. A buyer that—

Q. No, we are not talking about a buyer. We are just talking about this hypothetical corporation that would give you that much money.

A. I am assuming that this company was a purchaser of the property for a value or substantially that, the nearest figure to that would be \$4,895,000.00 value to a buyer which would return him 7 per cent interest.

Q. No, I want to know the taxes, that is all I

(Testimony of John Alden Grimes.)

want to know. How much tax would that corporation have to pay?

A. Well, this is the answer for an individual.

Q. No, I don't——

A. An individual buyer. It is a slightly different basis. The average owner of the company would have 73.55 per cent of his income after his cost of depletion, so that he would have to pay taxes on the money he would be in receipt of, and the other 26½ per cent of his income would be allowed cost of depletion.

Q. That is right. Now, referring to this statement of tax paid by the corporation you have got 20½ per cent of its royalty paid as income tax.

A. About 23¼ per cent of the royalty income paid as taxes.

Q. How do you figure your cost of depletion, apply some barrelage basis? [750]

A. No, that is figured by getting the compound interest discount factor for total income. That is, what value each year's income had and apply a discount factor and then adjust for taxes.

Q. Your cost of depletion?

A. Why, surely. You are only paying with the income that you get back the tax from.

Q. Don't you develop the price for the average year's barrels and determine your depreciation from that?

A. Well, that is the same. I gave here a figure of depletion in terms of dollars of income, and we have a fixed price per barrel of oil, so that you get

(Testimony of John Alden Grimes.)

one rate on your dollar or you get one rate on your barrel, but they would be slightly different rates, depending on which one you are using.

Q. I know, but I am referring to the cost of depletion. Isn't it a fact the Government generally takes the value it sets or the cost, and divides barrels into that that to find the unit depletion?

A. Yes, that is the customary way.

Q. So they would apply that depletion rate to each barrel of oil that is pumped up?

A. That is right. And then, of course, the price changes. I don't use that method in my determination on the dollar income, because the price is going to change from day to day, and in all of these valuations we assume a uniform price throughout [751] the entire time of the life of the property, and when you do that you can figure a certain percentage of your dollar of income as depletion.

Q. What has the price of oil got to do with the cost of depletion?

A. It is just simply a method of estimating on how much of the total expected future income is coming to get taxes from. Now, you have got to get that tax expressed in terms of dollars. You can figure so many dollars of tax per barrel of oil and then multiply by the barrels of oil, but you have got to get it down to dollars.

Q. All right. Now, Mr. Grimes, let's assume that a corporation purchases for \$4,800,000.00 approximately so many barrels as estimated in the ground.

A. Yes.

(Testimony of John Alden Grimes.)

Q. Now, over how long a period would the Government allow that purchaser to spread his costs?

A. Over the remaining barrels of oil in the ground.

Q. That would be to 1965, wouldn't it?

A. In years, when I evaluated it it was to use up to and including 1965.

Q. It is your opinion, isn't it, in trying to determine the value of oil royalties, that you must take into consideration the estimated value of oil reserves and that the barreling stipulation has some bearing? [752]

A. I don't know whether I quite get your question.

Q. I don't either. I will withdraw it. By spreading that \$4,800,000.00 over the life or expected life of this field, what was your unit of depletion per barrel?

A. Well, I haven't figured that, but I will tell you how it could be figured per barrel. We have a certain total number of barrels less our equity, and you have got a total that is right in the exhibit here. I have that all figured, but you jump from one thing to another and I missed it.

Mr. Melville: Maybe this is what you are looking for.

The Witness: No, what I have in mind is right here. We have 7,992,871 total barrels of oil from all of these properties. We have \$9,029,979.00 of total expected royalty income. Now, it is simply necessary to find the ratio between those two.

(Testimony of John Alden Grimes.)

By Mr. Mackay:

Q. Well, let's compute it.

A. That is quite a job. I have the figures located up here, but didn't try to derive that accurately.

Q. Here is a slide rule Mr. Paine has.

A. Thank you, Mr. Paine. I think it is about 75 per cent. I can't——

Q. 75 per cent of what?

A. No, it has got to be more than that. If I divide— [753] there is approximately 8,000,000 barrels of oil and there is approximately \$9,000,000.00, which is approximately \$1.11 per barrel of oil.

Q. How much?

A. Practically \$1.11 average price per barrel of oil.

Q. And do you think that is reasonable, in the ground?

A. No, I am not taking in the ground. That is the price at the surface.

Q. Well, I thought you said that you took the total barrelage estimated oil reserves, somewhere in excess of 7,000,000, around eight, and you divided that into \$9,000,000.00, is that right?

A. No, I was just dividing the barrels of oil in the dollars of income. Now, I thought we were talking about—I had been talking about a certain percentage of each dollar of income that was returnable tax-free through depletion on a cost basis. Now, if you do that in terms of barrels of oil——

(Testimony of John Alden Grimes.)

Q. Just a minute. Let me ask you another question. Will you please take your valuation figure of approximately four million some hundred thousand dollars and divide that by barrels so that we can determine what price you think the oil is worth in the ground?

Mr. Melville: If your Honor please——

The Witness: Well, approximately 8,000,000 barrels, so that would be in rough figures 60 cents a barrel. [754]

Mr. Melville: I believe there is an exhibit here which shows the price per barrel of oil which both parties are in accord upon in treating the total amount of oil reserves and the future probable income.

Mr. Mackay: Oh, no, let's read the stipulation.

The Court: Well, it is figured on a basis of about \$1.13. Didn't you mention it several times?

Mr. Mackay: Yes, that is the revenue.

The Witness: I was talking about revenue, too, until now. I must have misunderstood counsel's question.

By Mr. Mackay:

Q. Well, to make it perfectly clear now, you have said in your opinion the oil royalty is worth four million eight?

A. That is right, and approximately 8,000,000 barrels, so it would be worth approximately 60 cents per barrel in the ground.

(Testimony of John Alden Grimes.)

Q. 60 cents a barrel in the ground?

A. 60 cents per barrel.

Q. And that is as to the holder?

A. To the purchaser and to the buyer.

Q. That is right. You heard Mr. Pemberton testify, didn't you, to the price that he assigned to oil in the ground in the Grubb Estate?

A. Yes, I heard him testify. I have forgotten what the figure is. [755]

Q. I will withdraw that. You heard Mr. Pemberton testify that the price at which the royalty interest in the Grubb Estate sold for reflected a value per barrel of oil in the ground at 60 cents, didn't you?

A. I have forgotten what his testimony is, but if you say that is it, I will accept it.

Q. Let's assume that it is so, and assume the record shows that. You also heard him say that that was worth \$1.57 at the surface, didn't you?

A. I don't recollect any of those figures, but if you state they are true——

Q. Let's assume that it is true. Now, what in your opinion would be the fair market value per barrel in the ground of the Dominguez Estate Company royalty, whose oil was at that time worth \$1.13?

A. I would not use that basis of comparison, because the last Grubb sale was in 1938, under different market conditions. I just would not apply that to 1941.

Q. Didn't I understand you to say on direct

(Testimony of John Alden Grimes.)

examination that you had made a comparison of that?

A. Yes, I had made a comparison. This company studies 50 per cent of the oil production of the United States, something over 50 per cent. They get confidential figures from companies as well as the public figures, and they make the most accurate and complete study that anyone makes. [756]

Q. Mr. Grimes, the substance of all that——

A. Well, the cost to the lessee to develop and drill for oil in the ground in 1941 was around 48 cents, and the lessee had to pay lifting costs, also had to drill that the lessor doesn't have to pay for, but simply 25 per cent on the cost of discovering and drilling oil, which is not unreasonable.

Q. Will you answer the question? I object to that as not responsive.

Mr. Melville: He is trying to explain his answer. He has a right to.

The Court: Please don't let's talk all at once. The reporter can't get it. Mr. Mackay made the objection that the testimony was not responsive to his question. I thought that also, and I might have sustained the objection. The witness has wandered a little after that. However, of course, it is correct, as the Colonel states, that the witness should be permitted to explain his answer, and we certainly want to allow him some latitude. I think, however, that we will suspend at this time on the cross-examination of the witness, and Mr. Mackey may

take it up later. We will be off the record for a moment.

(Discussion off the record.)

The Court: Let the record show, Mr. Reporter, we are suspending at this time until 2:00 o'clock.

(Whereupon, at 12:30 p. m., a recess was taken until 2:00 p. m. on the same day.) [757]

Afternoon Session, 2:00 p. m.

JOHN ALDEN GRIMES

resumed his testimony as follows:

Cross-Examination (Resumed)

Mr. Mackay: Mr. Reporter, please read the last question.

The Court: I think I probably broke up your last question, Mr. Mackay, by my remark.

Mr. Mackay: I think that is quite all right. I don't mind. I can reframe it, I think.

By Mr. Mackay:

Q. Mr. Grimes, let's assume that the oil royalty in the Grubb Estate was sold on the basis of 60 cents a barrel for oil which yielded \$1.57 per barrel when produced; what would be the comparative price per barrel of the Dominguez Estate oil at \$1.13?

A. Just a ratio of those two as of 1938, but I am not accepting that. [758]

(Testimony of John Alden Grimes.)

Q. Just tell me what is the ratio?

A. Well, it is the ratio of the two prices.

Q. Well, figure it out and tell me what the price on the barrel would be.

A. May I have the figures, please? Will you repeat your figures?

Mr. Mackay: Please read them.

(Question read.)

A. If my computation is correct, \$1.13 is 72 per cent of \$1.57, and if I were making any such comparison as that I would have 72 per cent of 60 cents, or 43.2 cents.

Q. That is right, isn't it? So upon that basis that would be a comparative value for the oil, wouldn't it?

A. No, it would not because this was the Grubb Estate.

Q. I said upon that basis, if this basis was correct.

A. I think those figures are correct, but I do not admit the correctness of the basis.

Q. No, just assuming the basis is correct.

A. Assuming your basis of comparison is correct, I think it would figure 43.2.

Q. And that would be the comparative value of this oil in the Dominguez? A. No.

Q. I mean assuming that that basis is correct.

A. No, I am not going to assume 1938 prices as correct for 1941.

Q. No, but just assume, can't you assume it just now without hurting you?

(Testimony of John Alden Grimes.)

A. I am willing to assume that this would be a correct basis for Dominguez in 1938, but that is as far as I am willing to assume.

Q. You don't want to assume what I asked you to assume? A. No.

Q. Now, Mr. Grimes. I think you said that the Grubb Estate was forced to sell it royalty and for that reason the transaction could not be used as a comparative?

A. No, sir, I think you misunderstood me. I said that the Grubb Estate sold these royalties in order to pay inheritance taxes. Now, they could have sold either the royalties or something else that the Estate owned, and it was not forced sale of the royalties, but I said that it had some aspects of a forced sale, in my opinion.

Q. What aspects?

A. Simply that they had to sell something to get money to pay taxes.

Q. Couldn't they have borrowed the money?

A. I imagine they could, at least in part.

Q. Don't you think they could have borrowed the whole [760] amount?

A. Well, I will assume that they could.

Q. Well, then, if they could have borrowed the money to pay that tax, then it has no aspect of being a forced sale, is that a fact?

A. No, I couldn't say that. If they borrowed the money they pledged the whole estate as security for the loan.

(Testimony of John Alden Grimes.)

Q. You mean to say that they would have to pledge the whole estate?

A. They would have to pledge something that was ample security.

Q. I know, but do you know the size of the estate? A. No, I do not.

Q. Don't you know as a matter of fact that the oil property was producing about \$4,000.00 a day?

A. No, I am not familiar with the details.

Q. You are not familiar with the details. Then you don't mean, do you, to give the Court the impression that there was any aspect of this sale that was in any way to be considered a forced sale?

A. I said I didn't consider it because I thought that it had some of the aspects of a forced sale. I am not testifying as to whether it was a forced sale or not.

Q. Will you please tell the Court in what respect it had some aspects of a forced sale? [761]

A. I think I have explained that.

Q. Can't you do it now?

A. Yes, I can repeat my explanation.

Q. All right.

A. I said that the estate had heavy federal taxes to pay and I imagine state inheritance taxes too, and that they had to sell something or—I will accept your amendment—or borrow money in order to pay these taxes. They chose to sell the oil royalties rather than to borrow money or sell something else that the estate owned, and in my opinion that had some of the aspects of a forced sale, so I did

(Testimony of John Alden Grimes.)

not consider the matter as a proper basis for comparison. Now, if anybody else considers that it is not a forced sale, I have no objection at all to their using it or considering it to be a free sale.

Q. Well, Mr. Grimes, you as a government engineer would not want to convey to the Court the idea that there was a forced sale or that it had any aspects of a forced sale unless you had made a sufficient investigation to determine the truth of it?

A. I am not testifying as to the fact that it was not a forced sale or a free sale, but I said I did not consider that sale in arriving at my opinion of the value of the royalties of the Dominguez Estate Company, because it was the only large sale of royalties which I was able to get track of for [762] some years back of 1941, and that considered personally that it had some of the aspects of a forced sale, and since I had that opinion I did not use it.

Q. I think you also stated in direct examination that the pumping of wells was not curtailed in the Los Angeles area, in the Dominguez area?

A. It is my understanding that curtailment applied principally or exclusively to flowing wells, that there was very little or no curtailment of pumping wells at any time in California.

Q. Now, would you change your opinion if you knew as a fact that the pumping wells were curtailed as well as the flowing wells? Will you answer me yes or no, please?

A. Yes, to the extent that the curtailment was identical.

(Testimony of John Alden Grimes.)

Mr. Mackay: Would you read me the question and answer, please?

(Question and answer read.)

By Mr. Mackay:

Q. Identical with what?

A. Identical percentages of curtailment with respect to both pumping and flowing wells, and I would like to change that answer, if I may. I would not change my opinion because I do not think that the price per barrel of daily production has any place in the valuation of a group of oil [763] wells as compared to another group in a different state of development, and I do not consider that it has any place when there is any curtailment of any kind; that that method applies perhaps fairly well to a single well over its flush production, that has a fairly well established rate of production, and it is just a version of the pay-out method, and I think a more inaccurate method than the one based on income.

Q. Just a minute, witness. I don't mind hearing you argue when we reach the argument in the case, and that is all right, probably. Now, what effect, in your opinion, would curtailment have upon your value?

A. If your price is based upon full production, say your well can produce a thousand barrels a day and you say that is worth \$1,000.00 a barrel of daily production, that would be worth a million dollars

(Testimony of John Alden Grimes.)

even. Now, if that well was curtailed to 500 barrels a day production and you still valued it at \$1,000.00 a barrel, we have only got \$500,000.00 value. You have just cut your value in half by that curtailment.

Q. That is right. Now, assume that you had curtailment here for say 10 years immediately after 1941; isn't it a fact that your recovery of the probable oil would be delayed considerable? Can you answer that yes or no?

A. No, I can't answer it that way. It depends upon [764] where the curtailment was greater or less than that in effect in working out the schedule of probable future production.

Q. Well, suppose it was greater, and you deferred the getting of your oil out for another 10 years, would that effect your value?

A. Not as of the date June 5, 1941, if it was a subsequent event. If it was definitely foreseeable June 5, 1941, and I had not taken it into consideration, it certainly would affect my opinion.

Mr. Melville: Mr. Mackay, do you want him to assume something, assume a different set of facts than any stated in the stipulation? Will you clearly present the facts you want him to assume?

Mr. Mackay: If your Honor please, this is cross-examination.

By Mr. Mackay:

Q. Now, Mr. Grimes, did I understand you to say that it was your opinion that the value per

(Testimony of John Alden Grimes.)

share of the Dominguez is equivalent to the fair market value of the total assets divided by the total number of shares outstanding?

A. That is right.

Q. That is your opinion. What justification do you have for your statement that in a family corporation the shares are of very little importance?

A. A family corporation is much easier to liquidate [765] than one which has shares held by twenty or forty thousand stockholders. The stockholders are a whole lot closer to getting possession of the assets at any time it becomes for the benefit of the majority to do so.

Q. Why more so than in any other corporations, like, say, the Lehmann Corporation?

A. Well, that is very widely held by the public and the stockholders will have entirely different suggestions, different ideas, and not such friendly cooperation as you would have in a family; if it became to the advantage of a sufficient number of members of the family to liquidate the corporation, it could be done.

Q. Now, suppose that your willing buyer of the stock of Dominguez happened to be an outsider, one who is not in the family?

A. That is right.

Q. Would your opinion be the same?

A. As to his being able to get his liquidating value?

Q. Yes. A. No.

Q. And then if you had a willing buyer who is

(Testimony of John Alden Grimes.)

not a member of the family, you would not base that on the asset value, then, would you?

A. No, to an outsider who was in no manner connected with the family, I would not base it upon asset value. [766]

Q. Now, you go down through the corporations on the same basis, don't you, with no discount whatever?

A. That is right.

Q. Don't they provide any discount?

A. You mean on the asset value or from the value of the assets?

Q. I should have made that clearer. I am sorry. You take in the asset values of Dominguez and you divide them by the number of shares. Now, getting down into the Francis Land Company, as I understand you to say, you appraised the Francis Land Company stock, I think, at a hundred and ten per cent of the appraisal you put upon the Dominguez Company, didn't you?

A. That is correct.

Q. And now, doesn't the Francis Land Company have to pay taxes at least on 15 per cent?

A. Yes, that amounted to about seven thousand average yearly taxes and overhead expenses, a total net expense of running the corporation, about seven thousand a year from 1936 to June 5, 1941, inclusive. It was somewhat lower in 1940. It was about \$4,000.00.

Q. Now, suppose that you had 10 corporations owning stock in each other instead of three, as we have here, would you still be of the opinion that

(Testimony of John Alden Grimes.)

the stock of the tenth would be worth the value of the assets of the first? [767]

A. If they were just a group of family corporations and formed to show or to enable the family to have an easy way of passing on fractional interests in property, I should say yes. Now, corporate ownership of real estate, oil properties, and so forth has considerable advantages to a family group, because if the administration is handled by one person, a corporation, instead of having to get the consent of a great number of individuals to any course of action.

Q. Now, Mr. Grimes, would your testimony with respect to the Francis Land Company stock and the Carson Estate Company stock be the same you had this morning in respect to Dominguez, so far as an outsider buying that stock?

A. Yes. I don't think any outsider would buy into a family holding company unless he could get the stock for a bargain price. Now, that is quite exceptional. I don't know that there are some sharpshooters, let's call them, that do buy into situations like this simply to make such a nuisance of themselves that they can sell it for more than their stock is worth, but I am eliminating that classifying.

Q. But you would not have an informed willing buyer willing to pay that and a seller who is equally informed getting paid for it. That wouldn't happen in this case, would it, if you eliminated it?

A. For anyone buying strictly for income taxes,

(Testimony of John Alden Grimes.)

I should judge that the stock outside of the families would sell [768] for a lower price than it would sell within the family, or be worth to family members.

Q. Now, Mr. Grimes, I would like again to call your attention to Page 2 of your book. This is your book, isn't it? A. Yes.

Q. I want to ask you a question about this, and whether or not you are of the same opinion now as you were when you wrote the book.

A. I think I am, yes.

Q. "The price at which income producing property passes from one owner to another is determined not only by its value, but by such intangible elements as comparative knowledge, buying ability and foresight of the buyer and seller. The asset value depends upon the ability of the valuator to reach his own conclusions based upon the elements determined by analysis of prospective transactions as well as completed transactions, and consideration of those important factors plays a part in an exhaustive valuation." I think you have answered the question that you are still of the same opinion?

A. Yes, I am.

Q. I will ask you, Mr. Grimes, where in your valuation here you gave effect to the need of the buyer or seller, or to the bargaining ability of either or both?

A. I am assuming that this would be a free transaction [769] on an open market, and knowing that these stocks were available to the public, I have to use the market for similar stocks as an

(Testimony of John Alden Grimes.)

indication of their value. If all of the stock of any of these companies should be listed upon a reputable stock exchange, I think it would still have the values to which I have testified, including \$558.78 for Carson, which I didn't have in direct testimony.

The Court: What is that?

The Witness: \$558.78.

Mr. Mackay: Just a moment. I think the answer is not responsive to the question, if your Honor please.

The Witness: I am sorry.

The Court: Well, it seems to be preliminary, and had you finished answering the question, Mr. Grimes?

The Witness: No, I had not.

Mr. Mackay: I don't want to stop you unless you are trying to argue the case.

The Witness: I tried to resolve all of these intangible elements by using the market for comparable stocks and minority stocks of comparable companies. In order to make a valuation at all, you must assume that these stocks are sold under comparable circumstances. The conclusion of my remarks was a mathematical or analytical appraisal which applies the discount methods and rate of receipt, and I didn't use that method in this valuation. I used the method of [770] comparing with the actual market.

Mr. Mackay: I see. That is all.

(Testimony of John Alden Grimes.)

Redirect Examination

By Mr. Melville:

Q. Mr. Grimes, in making your analytical appraisal, did you take into consideration whether or not the stockholders of these various stocks were willing to let it get outside of the family group?

A. No, I tried to figure a value that would obtain between a willing buyer and a willing seller if the stock were traded in upon a public exchange the same as other oil royalty stocks which I have used as a basis for comparison.

Q. Now, if the stockholders, members of the family groups, had a policy or practice to not permit the stock to get outside of the family group or if it did get out to buy it back, what effect would that have on the appraised value?

A. Well, that obviously would increase the price at which the stock could be sold.

Q. But you haven't added any factor to cover that possibility?

A. No, I have not.

Q. Assuming, Mr. Grimes, that the oil properties of the Dominguez Estate Company were for sale on June 5, 1941, and that among the prospective willing buyers there were corporations and there were individuals, individuals being [771] in various tax brackets, do you have any opinion as to who would be the highest bidder for the oil royalties?

A. I should think either a corporation or a group of individuals in relatively low income brackets, not those that had the highest tax brackets.

(Testimony of John Alden Grimes.)

Q. Mr. Grimes, following the same methods that you followed in valuing the oil properties of the Dominguez Estate Company, have you valued the oil royalties of the Carson Estate Company?

A. Yes, I did so before the value was stipulated. I have used the stipulated value of \$285,000.00 in my determination of the value of the Carson stock.

Q. Your testimony, then, in this case is based upon the stipulated value of \$285,000.00 for the oil royalties of the Carson Estate Company?

A. That is right.

Q. Now, prior to the stipulation of \$285,000.00, did you independently arrive at your opinion in the same manner and using the same methods as you used to value the oil properties of the Dominguez Estate Company, and arrive at an independent appraisal of the oil royalties of the Carson Estate Company?

A. Yes, I did.

Q. What was that opinion?

A. \$276,000.00, and I would like to explain that I [772] followed the same method, but I did not use 9.67 times earnings. I used 6 times earnings.

Q. Would you state why?

A. Because I considered the Carson royalties were considerably poorer in character, judging from future expectation, than the Dominguez. They are telescoped more into the early period and seemed to have a much more rapid decline toward the latter part of their productive life.

Q. Mr. Grimes, the various opinions that you

(Testimony of John Alden Grimes.)

have expressed during your testimony in this case, what were they based upon?

A. They are based upon my opinion of what these stocks might have been sold for if offered to the public and listed upon public stock exchanges. They are based strictly on what I consider the market price of the stocks would be, and I arrived at that opinion by means of averaging what stocks of other oil royalties were selling for, which I considered to be comparable.

Q. In making appraisals, Mr. Grimes, do you consider that the result is dogmatic?

A. No, I think it would take a fine appraisal to be right within 10 per cent plus or minus.

Q. In formulating your opinions, which you have expressed in this case, did you or did you not base those opinions on appraisals which you thought were correct within [773] the margin you have just stated?

A. Well I tried to figure it. My figures are strictly appraised figures, and if they are right within 10 per cent above or 10 per cent below those figures, I would consider they were very fine appraisals. I just don't think appraisals can be made more accurately than that.

Q. Have the figures that you have expressed in this case been based upon such appraisals?

A. Yes.

Mr. Melville: No more questions.

(Testimony of John Alden Grimes.)

Recross Examination

By Mr. Mackay:

Q. Mr. Grimes, I understood you to say that in computing the value of the Carson royalties, you used six times earnings, is that right?

A. That is right.

Q. Well now, what if you used that same figure, six times earnings, what would be your value for the Dominguez?

A. Well, I could figure that out, just the difference between six and 9.67. I didn't use any such figures.

Q. Well, that would cut it about in half, wouldn't it, Mr. Grimes, your value?

A. Oh, no, 60 some percent on the royalties.

Q. In other words, it would produce a much lower value, wouldn't it, to use the same earnings?

A. Oh, obviously, if you multiply the earnings by a lower figure you are going to get a lower value.

Q. Well, they are pretty much holding companies?

A. We were talking strictly about the oil royalties, not about holding companies.

Q. Yes, that is what I mean. So that if you applied the same basis of six times earnings to the Dominguez as you did to the Carson you would get a value very much lower than the value you have placed on it, wouldn't you?

A. Yes, but that would not be my opinion of the value of the Dominguez.

Mr. Mackay: I think that is all.

Redirect Examination

By Mr. Melville:

Q. Mr. Grimes, what affect, if any, did it have upon your viewpoint and your methods of appraisal, the fact that the parties to this case stipulated to \$285,000.00 for the value of the Carson Estate Oil royalties?

A. Well, of course, it was very pleasing to see that Mr. Paine and I had arrived at such close approximation of the value of the particular asset.

Mr. Melville: No more questions.

Mr. Mackay: No more questions.

The Court: Both sides are now both through with Mr. Grimes, so that so far as examination is concerned, he may be excused, is that right, gentlemen? [775]

Mr. Mackay: That is right, your Honor.

Mr. Melville: That is right, your Honor.

The Court: Very well.

Mr. Mackay: I would like to call Mr. Paine.

PAUL PAINE,

recalled as a witness for and on behalf of the Petitioners, having been previously duly sworn, was further examined and testified as follows:

Further Direct Examination

By Mr. Mackay:

Q. Mr. Paine, you were in Court yesterday and heard Mr. Phillips testify, did you not?

A. Yes, sir.

(Testimony of Paul Paine.)

Q. And you heard him refer to the report of the Dominguez Oil Fields that you made?

A. Yes, sir.

Q. Can you tell the Court for what purpose that was made? Yes, sir.

Q. Please.

A. That report was not a report estimating the market value of the Dominguez Oil Fields properties or its stock. I was engaged for the purpose of estimating the oil in the ground, the probable future profits that would be derived through its recovery, and that report accomplished that and [776] ended there. The finding of the report finally was expressed as an estimate of so many barrels of oil recoverable and the probable profit it would yield in the course of time. Then to this future estimated price was applied a discount and the present worth thereby ascertained. That present worth figure was about \$66.00 per share of stock, on the 400,000 outstanding shares of the company. At that point my part in that ceased, the bankers—the report was delivered to the bankers. They then conducted their negotiations. The present worth as I found it was \$66.00 a share. The bankers paid \$32.50.

Q. Did you set out a formula in your report?

A. No, I didn't. There was no formula.

Q. Now, you have heard some testimony with respect to the Grubb property. A. Yes.

Q. You are familiar with that, aren't you?

A. Yes, I am familiar with the property.

(Testimony of Paul Paine.)

Q. I think you testified on direct examination that you were consultant, engineering consultant for the Bank of America? A. Yes, sir.

Q. At about the time this sale was made, were you consulted about the properties?

A. I was. Yes, I was asked about the properties and about the situation there, because the bank was just considering [777] the question of a loan to the estate and I was asked what I thought of the merits of a loan to the estate. My reply was that I didn't know what the estate was worth, I had made no appraisal of it, of the whole assets, but undoubtedly they go up into a number of million dollars safely.

Q. In making a loan?

A. Oh, yes.

Q. What have you to state with respect to the testimony of Mr. Grimes that the sale had the aspect of a forced sale?

A. Well, if I am required to answer that I would say he is mistaken. I can understand very well how he could be mistaken. This estate had a tremendous amount of property. Mrs. Grubb when she died had a lot of money, and it took all the money she had to pay the inheritance tax, and then this sale was brought about in connection with their undertaking to secure the balance of the funds necessary. The trade was a unique one in this respect, that it did not offer a certain percentage of royalty or a certain royalty interest to the highest bidder. They desired to know who would accept the smallest portion of that royalty in return for

(Testimony of Paul Paine.)

this amount of money which they were seeking.

Q. Now, Mr. Paine, can you tell the Court whether or not at this basic date, June 5, 1941, there was any curtailment on public wells?

A. A great many of the public wells in the Dominguez [778] field were greatly curtailed at that time.

Q. As well as the flowing wells?

A. Oh, yes.

Mr. Mackay: Take the witness.

Cross Examination

By Mr. Melville:

Q. Mr. Paine, are you a graduate engineer?

A. Yes, sir.

Q. What school?

A. From the Massachusetts Institute of Technology.

Q. What degree? A. Bachelor of Science.

Q. In engineering?

A. They don't give it for engineering. I graduated, however. Answering your question, graduated in the course of geology. They have courses in civil engineering, mechanical engineering, electrical engineering, and so on, about a thousand of them. One of those courses is geology. In that I took my degree.

Q. And received a Bachelor of Science degree.

A. Yes.

(Testimony of Paul Paine.)

Q. This Dominguez Oil Field property appraisal that you refer to, what year was that in?

A. I think it was 1938.

Q. Or was in 1934? [779]

A. No, July 21, 1938.

Q. Did you consider the situations involved in the Dominguez Oil Fields property appraisal that you made in 1938 controlled or strongly influenced the situation of the questions involved in this case, which related to 1941?

A. May I have that question, please.

(The question was read.)

A. That sounds like an awfully complex question to me. I shall try to answer it.

Q. If you don't understand it, I can rephrase it for you.

The Witness: I don't want to avoid this now, your Honor.

By Mr. Melville:

Q. Please tell the Court what went into your explanation of the Dominguez Oil Fields property appraisal in 1938, on your direct examination.

A. I was asked if I had heard Ralph Phillips yesterday relate about this appraisal, and about the formula which he had followed in estimating the value of this property in 1941 and to which he testified.

Q. Is that true——

A. Now, may I finish?

Q. Surely.

(Testimony of Paul Paine.)

A. And I was told about this report, and you asked me [780] now—state your question.

Q. I am wondering what the connection is between that report and our case.

The Court: May I ask counsel, you used the word controlling, what did you mean, controlling upon this witness or what?

Mr. Melville: No, no, influenced in any manner any opinions that this witness may have expressed.

The Court: Did you understand the question? I am sorry, I didn't.

The Witness: I am sorry. I did not.

Mr. Melville: I will start over again.

By Mr. Melville:

Q. Mr. Paine, do you think in forming an opinion as to the fair market value of the oil royalties of the Dominguez Estate Company as of June 5, 1941, that the report of appraisal that you made as to the Dominguez Oil Fields property in 1934 has any bearing?

Mr. Mackay: I object to that, your Honor, 1934; the record shows 1938.

Mr. Melville: All right, 1938. I will correct the question.

The Court: I would be inclined to think that if the question of something along that line is proper, it would have to be confined to whether or not this witness has taken such into consideration himself. Now, it will be our peculiar [781] province to deter-

(Testimony of Paul Paine.)

mine whether there is any connection between the two.

Mr. Melville: Well, maybe I am confused, your Honor, and your Honor quite unconsciously went along with me. The first thing we talked about on direct examination was this Dominguez Oil Field property appraisal in 1938, and I am frankly confused, I don't know the purpose for which it was taken up. I would like to have the record, or at least myself cleared up on that.

The Court: Well, Mr. Phillips made some reference to it during his testimony. Now, whether he thought that there was some formula in there and that he was applying—I think he stated in a general way that he had relied upon a formula or some method of calculation as contained in that report.

Mr. Melville: Was this witness then for the purpose of impeaching the testimony of Mr. Phillips?

The Court: Well, I would think that perhaps that is the primary purpose, although I can't say why counsel put the witness on or asks a certain question.

By Mr. Melville:

Q. Well, Mr. Paine, what opinion did you express in this case as to the fair market of the oil royalties of the Carson Estate Company.

A. I didn't testify on that. That oil property—or that stock, I think you asked me about.

(Testimony of Paul Paine.)

Mr. Mackay: He is talking about oil properties.

The Witness: \$283,000.00.

By Mr. Melville:

Q. And what opinion did Mr. Phillips express?

A. I don't remember.

Q. I think the record will show it was two hundred eighty-five thousand some odd hundred. What significance do you attach to the fact that Mr. Phillips came within a few hundred dollars—within two thousand dollars, pardon me, and within a few hundred dollars of the stipulated fair market value of those oil royalties.

A. I can't guess that for you. I would have to guess. It would be an opinion.

Q. That is what you are up here now expressing.

The Court: I doubt it. No, we have him here as an expert to tell us what he knows and what his opinion is.

The Witness: I can relate——

The Court: Wait a minute.

The Witness: I am sorry.

The Court: When you get him over into the realm of guessing, I don't want to hear from him.

By Mr. Melville:

Q. Mr. Paine, were you an employee of the Grubb Estate in 1938? [783] A. Never.

Q. Then what you have testified to with respect to that estate was entirely hearsay?

A. No, sir.

(Testimony of Paul Paine.)

Q. Where did you get it?

A. Well, I heard Mr. Pemberton testify yesterday with respect to the price the property was sold for and what the estimates of the oil reserves were, and the equivalent basis per barrel of oil in the ground, at the time that transaction was made, also at that time I knew of the sale coming up and knew that this problem confronted the estate. I was asked by the bank officers to give them an indication of what I thought this property might earn, and in addition Guy Witter and I, and Guy Winter is the Southern California partner of Dean Witter & Company, discussed and made tentative efforts to try to buy that royalty.

Q. Did you consider the sale of that Grubb Estate oil royalty in forming your opinion that you expressed as to the fair market value of the oil royalties of the Dominguez Estate Company in this case?

A. That is one of the transactions that I took into account in my estimate, yes, sir.

Q. How much weight did you attach to it?

A. I can't say it in that specific form. It was the largest transaction of a comparable nature that I know of in [784] Southern California within recent years.

Q. You heard Mr. Grimes' testimony?

A. Yes.

Q. You heard what he said about the weight that should be attached to the sale of the Grubb

(Testimony of Paul Paine.)

Estate in 1938, in making valuations in this case?

A. Yes.

Q. Do you agree with him?

A. No, I do not.

Q. Why?

A. Because that transaction was conducted and closed on such a basis that the value of the oil in the ground was purchased on the basis of approximately 38 per cent of the price oil was bringing at that time. Now, that is a significant figure here to me, because that is not related to the time. That is the ratio of oil in the ground to the price it brings, and if later on oil went up in value and in return, I would expect the value of the oil in the ground to be greater. Now, applying that same ratio to \$1.13 oil, one gets a comparable figure on a percentage basis, that is, properly comparable, irrespective of the time element, of 43 cents per barrel. I used 40 cents a barrel in my estimate.

Q. And where do you get the price for the oil that you used in this comparison of price of the Grubb Estate oil?

A. Phil Pemberton testified right here the other day [785] confirming what I had.

Q. Do you know whether that is the posted price or whether it is——

A. Oh, no, that is not the posted price.

Q. Well, do you know that it is not?

A. Yes, because this figure is the return of revenue from oil, gas, gasoline, butane, protane, and other by-products per barrel of oil, which is the

(Testimony of Paul Paine.)

common unit that we use in these computations. You know one question was put to me, that is, where I got the figure of \$1.57 originally.

Q. No, I didn't ask you that.

A. I am sorry. I think the record will speak for itself, where did I get the figure of revenue per barrel of oil.

Q. I was referring to where you picked up or determined the price per barrel of oil to the Grubb Estate in making your comparison.

A. The price per barrel of oil in the form of revenue.

Q. That is right.

A. Yes, that is what I say I have not answered fully for you. Phil Pemberton testified to \$1.57. At the time of this transaction I asked Don Bartl, the field engineer of the Shell Company, what that amounted to, and he told me.

Q. Was that a gross price including all products and everything? [786]

A. Well, yes, if I understand you correctly. That is the revenue, the revenue, not the price, the revenue from oil plus the revenue from gas plus the revenue from casing-head gasoline and all other products added up and divided by the number of barrels.

Q. The gross revenue without any deductions for anything.

A. Yes, yes. I mean no deductions from Mrs. Grubb's income tax or administration that she had to pay for or anything of that kind. That is the

(Testimony of Paul Paine.)

dollars she received from the Shell Company per barrel of oil produced. Now, there were deductions.

Q. I think that answers the question.

A. No, it doesn't. I am trying——

Mr. Mackay: Let him explain it.

The Witness: There were some deductions probably, according to the terms of her lease, because very often the leases provided that as to the costs of gasoline or other products there shall be some contribution on the part of the lessor toward the cost of recovery of these by-products. I don't know what those were, but that is deducted before the money is passed over to the lessor. And this is the amount of money which came to her, divided by the number of barrels, and if that is what you mean by gross, that is my answer. On the other hand, if by gross you mean the total amount of money, I am sorry that just as I indicate that I am——[787]

By Mr. Melville:

Q. Go on if you want to.

The Court: I suggest we may be getting away from rebuttal, and certainly from cross examination on testimony that was given in rebuttal. Maybe I will have to stop it. I don't know.

By Mr. Melville:

Q. Mr. Paine, I think you imagine my question, now. What effect, if any, does the matter of curtailment in the Dominguez Oil Field have on the stipulated facts in this case?

(Testimony of Paul Paine.)

The Court: I am afraid that is a rather broad question, and perhaps invading our province, Mr. Melville.

By Mr. Melville:

Q. When you studied the stipulation of fact in this case, Mr. Paine, did you consider that the agreed future production in royalty dollars took into consideration the probable curtailment in the Dominguez Oil Field?

Mr. Mackay: If your Honor please, I object to that as not proper redirect.

The Court: He may answer if he knows.

The Witness: Well, I was a little doubtful about it as I observed the figures, because they seemed to conform to the actual production.

Mr. Melville: Answer the question yes or no and then explain it. [788]

Mr. Mackay: May I interject here?

Mr. Melville: I think he is capable of answering that question.

The Witness: Let me make sure of the question.

(The question was read.)

The Witness: Oh, yes, we assumed that in this stipulation you had taken into account every element. I accepted the stipulation 100 per cent.

By Mr. Melville:

Q. So that any of your testimony here on direct examination as to curtailment is not intended to change your opinion or anybody else's opinion?

(Testimony of Paul Paine.)

A. No, it is intended to impeach Mr. Grimes, as far as I am concerned. He didn't know the fact.

Q. Well, do you consider that Mr. Grimes had to go beyond the stipulation in determining as to what extent there was curtailment——

Mr. Mackay: I object.

Mr. Melville: I am sorry. I have not finished.

The Court: You may complete your question, then I will hear the objection before the witness answers. Read the question, please, Mr. Reporter.

(The question was read.)

Mr. Melville: In the Dominguez Oil Field, in order to arrive at an opinion as to the fair market value of *the* [789]

Mr. Melville: That is all.

The Court: Are you through with Mr. Paine, now? May he be excused from further attendance as far as this case is concerned?

Mr. Mackay: Yes, he may.

Mr. Melville: Yes, your Honor.

The Court: Very well.

Mr. Melville: Now, your Honor, the Respondent's case is in except for the matter of the minutes of the directors and stockholders meetings of the Dominguez Estate Company, Francis Land Company, Carson Estate Company, and Reyes Dominguez Company, as to which it is hoped by us counsel can reach an agreement; secondly, the matter of sales and gifts of the various stocks, Dominguez Estate Company stock, Francis Land Company

(Testimony of Paul Paine.)

stock and the Carson Estate Company stock, over a period of years from 1935 to 1941, and as to those it is quite possible that opposing counsel can reach an agreement and stipulate. I, therefore, suggest, your Honor, that we adjourn this case until the latter part of next week.

The Court: Very well. We may be off the record for the time being.

(Discussion off the record.)

The Court: The record may show, Mr. Reporter, that we suspend at this time. The court is suspending until 9:30 Monday morning, but so far as this case is concerned it will [790] agreed future income in the Dominguez Estate Company case?

Mr. Mackay: If your Honor please, I object to that, it seems to me that that question is entirely beyond the pale of cross examination. It is too general, too indefinite, and just asking this witness——

The Court: Oh, I am inclined to think so. We seldom permit one witness to appraise the value of another witness' testimony.

Mr. Melville: Your Honor, this witness voluntarily and without any response to a question on my part, voluntarily stated that he referred to it in order to impeach Mr. Grimes' testimony. That is an opinion.

The Court: Well, that is an opinion which we will ignore, but we are not going to try one witness by the testimony of another witness. We are try-

(Testimony of Paul Paine.)

ing a lawsuit. We are interested in the value of property, and not in what Mr. Grimes might think of Mr. Paine's testimony or vice versa.

Mr. Melville: I am terribly sorry, your Honor, but I didn't hear the last of your Honor's remarks. Has your Honor ruled on the question.

The Court: I sustain the objection to the question as phrased.

Mr. Melville: No more questions.

Mr. Mackay: That is all.

The Witness: May I—— [791]

Mr. Melville: That is all.

The Court: Are you through with Mr. Paine now? May he be excused from further attendance as far as this case is concerned?

Mr. Mackay: Yes, he may.

Mr. Melville: Yes, your Honor.

The Court: Very well.

(Witness excused.)

Mr. Melville: Now, your Honor, the Respondent's case is in, except for the matter of the minutes of the directors' and stockholders' meetings of the Dominguez Estate Company, Francis Land Company, Carson Estate Company, and Reyes Dominguez Company, as to which it is hoped opposing counsel can reach an agreement; and, secondly, the matter of sales and gifts of the various stocks, Dominguez Estate Company stock, Francis Land Company stock and Carson Estate Company stock, over a period of years from 1935 to 1941, and as to

those it is quite possible that opposing counsel can reach an agreement and stipulate. I, therefore, suggest, your Honor, that we adjourn this case until the latter part of next week.

The Court: Very well. We may be off the record for the time being.

(Discussion off the record.)

The Court: The record may show, Mr. Reporter, that we suspend at this time. The Court is suspending until 9:30 Monday morning, but so far as this case is concerned it will [792] be called at 4:30 p.m. Monday evening, October 15, 1945.

(Whereupon, at 3:15 p.m., October 13, 1945, the hearing in the above-entitled matter was adjourned until 4:30 p.m., Monday, October 15, 1945.) [793]

PROCEEDINGS

October 16, 1945, 4:40 p.m.

The Court: We may be on the record in the Cotton and Caldwell cases. I think we have the appearances.

Mr. Melville: If your Honor please, at this time I desire to file amendment to the answer in the Victoria L. Cotton case, a copy of which I have previously given counsel for petitioner.

Mr. Mackay: May I take a look at it? I have got two copies here, and I just want to make sure it is the one I have.

The Court: The document may be handed to the clerk and will be filed as of this date.

Just a moment. Let's see if I understand what I am doing, however. You are offering at this time an amendment to the answer. I might ask counsel for the petitioner whether there is any objection.

Mr. Mackay: Your Honor please, I suppose this is in the form of a motion to file an amendment. That is the reason I spoke.

The Court: Well, generally there is a written motion. However, it may be an oral motion made in open court, which is the situation I suppose.

Mr. Melville: Your Honor, I formally move now for leave to file an amendment to the answer in the Cotton case.

Mr. Mackay: If your Honor please, I object to the motion to file the amended answer, because I think that your [797] Honor will observe the amended answer attempts to increase by a withdrawal of certain admission in the answer the deficiency asserted by the Commissioner of Internal Revenue. The Division, as I understand, your Honor please, is presumed to be correct, and that is what we are appealing from. The only way as I see that the counsel for the Commissioner may increase a deficiency over the one asserted is by affirmatively alleging facts which would justify the increased deficiency.

Now, this answer, if your Honor please, strikes out—or I mean the motion proposing an amended answer strikes out the last paragraph of the answer, which is the last paragraph on page 1. Now, it

seems to me it is quite inappropriate for the Commissioner of Internal Revenue at this time to come in and withdraw his admission with respect to the allegations in the petition, and that is one of the reasons I object. The other is that what he is trying to deny now is the specific exemption which is alleged prior to the year 1940. Now, if your Honor please, the deficiency was based, or the Commissioner's claim of deficiency, as I stated a moment ago, is presumed to be correct. Now the Commissioner in his proposed amended answer, after trying to withdraw is in effect denying the basis for the deficiency, in his prayer he states "Wherefore, the respondent prays that the court redetermine the deficiency herein to be the [798] amount determined by the Commissioner, viz., \$7,845.75, plus an increased deficiency in an amount sufficient to conform to the proof with respect to the amount of specific exemption used by the petitioner prior to the year 1941, claim for which is hereby made pursuant to the provisions of Section 272(E) of the Internal Revenue Code."

If the Commissioner has any idea of increasing that deficiency, he must do that affirmatively, the Commissioner having already determined the deficiency based upon information set forth in our petition and the Commissioner himself, who brought us in here. If the Commissioner were now claiming certain things in the stipulation, that the value was different, that is something else. As it stands here though, if your Honor please, it is just entirely improper for such an amendment to be ac-

cepted. I have never seen in my whole experience before the Tax Court any practice whereby the Commissioner has been permitted to withdraw the denial and have an increased deficiency. That can only be done, as your Honor well knows, by setting forth specific allegations. For this reason I object to the motion to file.

Mr. Melville: What this motion is about, your Honor, is simply this: That at the time the original answer was filed the respondent did not have in his possession certain facts with respect to transfers of stock by the petitioner. I learned only last Saturday from one of counsel [799] for the petitioner that some transfers which I didn't know at the start were gifts or sales, I learned Saturday that they were gifts, and thus it raises a question about the prior transfers by way of gift which enter into the method of computing the deficiency in this case, so I feel that the government's interests need to be protected by withdrawing the previous admission with respect to prior gifts and denying them, thus raising the question which will be open to proof, as to what the prior gifts were.

Then if the proof is different than alleged in the original petition, then I feel it is in accordance with the court's rules that we can ask for an increased deficiency to conform with the proof.

The Court: Well, I think I will deny the application at this time to file a further answer. We have been trying here a gift tax, the issue in controversy being the value of the property transferred during the particular taxable year or years by gifts.

In computing the amount of the gift tax, gifts made in prior years clearly constitute one of the factors. So far as I know there has been no controversy raised as to those factors, and certainly none of the proof has been directed toward them. It may be that incidentally in the trial of the valuation issue some evidence may have indicated that perhaps the Commissioner should have increased the gifts of the prior years. Since he did [800] not do so, that of course is not an issue in the original proceeding. I think it would be rather poor practice for us, at practically the close of all of the evidence and after the petitioner had rested, to unsettle pleadings and have an amendment to the answer made, the effect of which would be to raise an entirely new issue. So I will deny the motion to file an amendment to the answer in the Victoria L. Cotton case. You may if you desire it part of the record let the amendment to the answer be lodged with the clerk, and it may be marked as lodged. If you desire to supplement the record by filing a written motion, you may do so, but I don't think it is necessary.

Mr. Melville: May I have an exception, your Honor?

The Court: Exception will be noted to the court's ruling. This may be marked as lodged by the clerk, not filed.

Mr. Melville: Your Honor, at this time I should like to move for permission to file in the Caldwell case an amendment to the answer. Now, if your Honor please, this does not change the issues that are involved in the proceedings in any way at all.

The purpose of this motion and the purpose in filing the amendment to the answer, your Honor, is to test a question of law. It is the respondent's position that it is material to this case if we can show that there were sales of this stock over a period of time prior to and including [801] the taxable year at a rather consistent price. In order to prove that, I would have to call in a number of witnesses and each one of them could be stopped from telling his story on the ground that it is not material, then we would have taken up the time of this court and the time of a lot of witnesses in an attempt to do something which can be tested by my filing at this time an amendment to the answer alleging these sales. It is my understanding that a proper motion will be made by Mr. Mackay and we will test the legality of this type of evidence. Do you have any objections if this is filed, Mr. Mackay?

Mr. Mackay: Yes, sir.

The Court: Well, the nature of the matter that I am now being asked to rule upon is your motion for leave to file an amendment to the answer in the Caldwell case?

Mr. Melville: Yes, your Honor.

The Court: And the proposed amendment to the answer has been handed to the clerk and may be marked as lodged with the court on this date at the hearing.

Now, upon the ruling on the motion does counsel for the petitioner desire to be heard?

Mr. Mackay: Yes, your Honor. I object to the filing of the answer, in opposition to the motion,

for many reasons. In the first place, counsel has stated to your Honor that it does not raise any new issue in the case. [802] That, to my mind, is fatal. I object to it further on the ground that what is alleged in the answer has no bearing whatsoever or any materiality or relevancy to the issue in this particular case, and certainly is not part of proper pleadings.

Directing, if your Honor please, your attention to the nature of the proposed answer, it says:

“Paragraph VII. That during the period from 1935 to 1941, inclusive, there were transfers of the common stock of the Dominguez Estate Company in amounts ranging from a fraction of a share to 1,100 shares, and that the transferrers as well as the transferees consistently placed a value of \$1,000.00 per share on said stock, whether transferred by way of sale or by way of gift and whether transferred at arm's length or otherwise.”

Now, the next paragraph is in exactly the same terms, if your Honor please. It relates to the common stock of the Francis Land Company. Now, it seems to me it raises no issue in this case, that the issue in this case is the fair market value on June 5, 1941, of these various stocks. It just seems to me that the proposed answer has no place here. It merely says that somebody somewhere somehow transferred and the transferee and the transferrer consistently placed a value upon the said shares, whether that was made [803] at arm's length or

otherwise. Now, if your Honor please, that sort of allegation or statement of facts has no place in any pleading, and I am sure that even if the facts were true it has no bearing or relevancy on the issue here. Your Honor is well familiar with the rule of law that if a sale is to be considered as having any value or any bearing upon a particular time or to determine value any particular date, the conditions I think must be given. If they just sold securities not reported in this statement and consistently did it and they had made communications this way and that way, whether it was all at arm's length or not, what would we gain by allowing such testimony in or even considering it?

In view of all the circumstances, if the court please, I object to the motion to file the proposed amended answer.

Mr. Melville: Your Honor, I think I correctly stated that it does not raise any new issue. The issue in the case from the beginning has been the fair market value of the stock in these three family corporations.

I am prepared, if necessary, to bring into court 10, 20 or 30, or any other number of witnesses to testify that they sold this stock at \$1,000.00 or \$1,100.00 a share. I was trying to avoid the necessity of bringing in all these witnesses, and I thought it was understood between Mr. Mackay [804] and myself that I would file such an amendment to the answer and we would test the question of the materiality of these sales. If your Honor should rule that such sales are material, then it is my

understanding that Mr. Mackay does not dispute the facts, would admit them, and we could avoid bringing in all of these witnesses. Whereas if your Honor denies the respondent the right to file this amendment on some of the grounds other than materiality, it would of course force the respondent to bring in his witnesses and at that time test the materiality of these prior sales.

I wish to comment a little about Mr. Mackay's reference to the fact that generally someone at some time sold someone and so forth. I have here a very lengthy answer to the petition in which I go into great detail. Mr. Mackay has a copy of that, so there is no question in his mind as to who the sales were to and who the sales were from.

Now, the last point I would like to make is this: The best evidence of fair market value of the stock is the price that it will bring in actual trading. I believe further, your Honor, that actual sales that I am in a position to establish pursuant to my allegations here would be in the nature of rebuttal at least. Some of the petitioners expert witnesses on stock valuation testified that it would change their opinion if they knew that actual sales had been made.

In closing, your Honor, I do not believe that it would be necessary for the respondent to amend the pleadings in any respect in order to get in the evidence with respect to these sales. I could simply have the witnesses in court, put them on the stand, go through the formality of questioning them, even though maybe their testimony, I appreciate, could

be objected to on the ground of immateriality. We are trying to avoid, as I said before, the necessity of doing that. I am not trying to file this amendment in order to change the issues or really to change the pleadings. That is not necessary for the respondent to allege affirmatively that sales were made. I have the privilege of producing evidence to that effect. I want to lay the groundwork for it, so that if your Honor rules that if these sales are material to the issue in the case, then I have reason to believe that Mr. Mackay will stipulate the facts. He knows the facts and I think we could get together on a stipulation, if your Honor rules that they are material.

Mr. Mackay: If your Honor please, I just want to make this observation. Mr. Mackay is not suggesting what the Commissioner should attempt to do, but for the enlightenment of the court, since counsel referred to it in his proposed amended answer, I might state that Mr. Mackay thoroughly disputes for the record any sale being made. I do not dispute the fact that under compromise settlement with certain attorneys that a certain price was paid—I want to [806] withdraw that, not that a certain price was paid, but if the government wants to show all the circumstances with respect to that, let them show that what they call sales were sales from a mother to her daughter for a note without interest taking 20 years to pay and paying it only out of dividends. I want to make it quite clear that Mr. Mackay is not admitting for the purpose of the record that there are any sales at all of these

stocks that would give the court any help upon the question here involved. Since counsel frankly admitted to the court that he is not raising any issue, of course, there is nothing for the court to do but to deny the motion.

The Court: Well, the court has considerable difficulty in ruling correctly upon the motion. Every indication has been given that counsel for both sides have commendably endeavored to shorten the trial.

The cases have already taken a week, however, for trial, and apparently the respondent is desirous of introducing additional evidence pertaining to or showing sales made at a time anterior to certainly the transactions in suit, the weight of course to be given to the evidence necessarily being contingent upon various factors. The relationship of the parties engaged in such a transaction would be pertinent and might be entitled to some weight. I think the time when those sales were made, particularly with reference to the time that the gift or gifts in issue [807] were made, would be pertinent and necessarily a factor to be taken into consideration by us in determining the weight to be given the evidence.

So I am confronted with a difficult situation to rule upon, when I am asked perhaps in an effort to shorten the trial, which is commendable on the part of counsel, in effect to rule upon the competency, materiality and relevancy and weight to be given certain evidence of which I have none but the vaguest notion, so far as the proposed amendment is concerned, and I would think that it is

probably not proper. Then in saying that I do not intend to imply or infer any criticism of counsel for offering it.

My own judgment is, gentlemen, that if you succeed in getting together upon the substance of the testimony which either side may desire, that is the additional testimony, my general understanding being that it consists in part of corporate minutes, resolutions of stockholders and directors, returns made by parties litigant before the court and by others—if you gentlemen succeed in agreeing upon those exhibits and presenting them in a short form, I have no alternative but to rule piecemeal upon all of the evidence as it is presented, so the motion to file the amendment to the answer will perforce be granted and we will reopen the proceeding immediately upon the conclusion of the trial of the two cases which have been assigned rather [808] definitely for trial and one of which is now in the process of trial.

In other words, about all I can say at this time is that we will suspend in the trial of the Caldwell and Cotton cases until we have concluded the trial of those two cases, which will probably be by Thursday of this week.

Mr. Melville: I would like to know if your Honor could give me a specific time. I may have to get out subpoenas in this case, and I would like to order these people into court at such time as your Honor feels it would not interfere too much with any case which is pending.

The Court: I don't believe I would attempt to

take that responsibility at this stage. You know as much about it as I do, and I say that without being critical. We are in the midst of the trial of the Powell case which originally was estimated to take two days and which has already taken two days. It is obvious that the trial of the Powell case will take some additional time, just how much I am not prepared to make any reliable estimate. The Neil case was set heretofore on the calendar to follow the Powell case, and those folks are waiting. They have estimated that it will take a day to try the Neil case.

Now, anything can happen overnight. All these cases may be settled or disposed of, so I would prefer just to let you gentlemen take your chances now.

Mr. Mackay: I might say this for the record, that counsel for the petitioner will see that any witness counsel for the Commissioner wants will be produced within reasonable time. I think I can get them in very promptly.

Mr. Melville: I will furnish you a list tomorrow, Mr. Mackay.

Mr. Mackay: Who is that, the Carsons and the Watsons?

Mr. Melville: The whole family.

Mr. Mackay: Well, anybody connected with the family, if they are in town, I will see that they are here for you, if you want them, without a subpoena.

Mr. Melville: Thank you, sir.

(Whereupon, at 5:15 p. m., a recess was taken to 3:30 p. m., Friday, October 19, 1945.)

PROCEEDINGS

October 19, 1945, 3:30 p. m.

The Court: Are you ready, gentlemen?

Mr. Melville: Your Honor, Respondent's Exhibit BB was withdrawn with leave to substitute a photographic copy. I believe I now have another extra copy which Mr. Arnold kindly found for me, and at this time I will file it.

Mr. Mackay: What is that, a report of what?

Mr. Melville: Report to stockholders dated March 25, 1941.

The Court: I think CC was the one that was to be furnished, a copy of the minutes.

Mr. Melville: Here it is, your Honor, copy of the minutes of the stockholders dated March 28, 1940.

The Court: That is CC, isn't it?

Mr. Melville: Yes, your Honor.

The Court: Then that will be received as Respondent's Exhibit CC.

Mr. Mackay: If your Honor please, may I check the record on that? That is a report to stockholders, is it not?

Mr. Melville: That is right.

Mr. Mackay: And that is dated when?

Mr. Melville: March 28, 1940.

The Court: Both of them, there was BB and CC marked as report to stockholders.

Mr. Melville: That was for the following year, [814] March 25, 1941, your Honor.

The Court: Oh, I see. This one is for a different year.

Mr. Melville: That is correct, your Honor.

The Court: Very well.

Mr. Melville: I offer at this time a report to stockholders covering the period preceding the meeting of the stockholders on April 14, 1937, presumably covering the 12 months previous.

Mr. Mackay: If your Honor please, as to that particular year, it is improper for them to go into this, and I think it is irrelevant and immaterial; therefore I object to it.

The Court: I am not sure I have followed just what you are doing here.

Mr. Melville: Your Honor, when Mr. Cotton was on the stand I was having him identify certain paragraphs in connection with laying a foundation for offering part or all of this report to stockholders in evidence. In order to save time I am willing to offer the entire report in evidence, because there are parts three which deal with the condition of these companies in 1936 and up to 1937. I will be glad to put Mr. Cotton back on the stand now and have him identify them, if that is necessary.

Mr. Mackay: No, you misunderstand me. I am [815] admitting that this is a true copy of a report to stockholders, but I am objecting to its relevancy and materiality.

The Court: This is one that we have not heretofore talked about or put in evidence, is that correct?

Mr. Melville: I had it marked for identification, your Honor. I was asking Mr. Cotton when he was

on the witness stand with respect to certain paragraphs of this.

The Court: I am only trying to reconcile or get my own recollection tied in with my notes here. Now I note on my memoranda, which are rather sketchy, that there was a document apparently having something to do with the minutes which was marked as Respondent's Exhibit DD, and then there was an excerpt read from the books, and the document itself which had been marked was not received in evidence.

Mr. Melville: This is it, your Honor.

The Court: And this is a copy of that, is that correct?

Mr. Melville: That is correct, your Honor.

The Court: Now, we have in the minutes themselves a marking as Respondent's Exhibit DD, marked for identification under date of October 12, 1945. Will it be then agreeable that we simply strike out the other marking and mark this particular document as Respondent's Exhibit DD for identification?

Mr. Mackay: Quite right. [816]

Mr. Melville: Quite agreeable. That permits them to keep the document in the book.

The Court: You may draw your pen through the marking, Miss Mies, and then re-mark the document which has been handed to you. It may be marked for identification as Respondent's Exhibit DD.

Now, your objection, Mr. Mackay?

Mr. Mackay: It is that it is irrelevant and immaterial.

The Court: Very well. The objection will be overruled and we will receive it, and if it has no materiality it will be ignored.

(Thereupon, the documents heretofore marked as Respondent's Exhibits CC and DD, respectively, were received in evidence.)

[Exhibits CC and DD are set out in full in Book of Exhibits.]

Mr. Mackay: May the record show an exception?

The Court: Exception may be noted.

Mr. Melville: Your Honor, I have a copy which was kindly made for me by Mr. Arnold of certain paragraphs out of the minutes of the directors' meeting of the Carson Estate Company on May 6, 1936, together with a copy of the notice of a special meeting of shareholders which is referred to in said minutes. I offer those as one document in evidence.

Mr. Mackay: May I take a look at it just a minute?

If your Honor please, we admit of course that these [817] are correct documents, but I want to call your Honor's attention particularly to the content of this before your Honor rules upon it. The minutes of the May 6, 1936, meeting, which are now proffered, merely authorize another new voting trust. I would like your Honor to examine it. It does seem to me that the minutes in this book, back almost six years, have to do only with the particular voting trust, and would have no materiality or relevancy to the issue involved in this case, and that

is the reason why I objected to it on the ground it is irrelevant and immaterial; it can have no bearing upon the value in 1941 whatsoever.

Mr. Melville: Your Honor, much has been said by witnesses, particularly the expert witnesses of the petitioner, with respect to minority interest and stockholder control and so forth. I wish the record to show when this case is finally submitted that the stockholders of the Carson Estate Company through a voting trust agreement controlled absolutely during the taxable year 1941 the Francis Land Company, and the significance of that can be readily understood if your Honor would refer to the chart showing the intercorporate relationships. I think it is material.

Mr. Mackay: If your Honor please, the stockholders always control the corporation.

Mr. Melville: They not only control the Carson Estate Company, but they control the Francis Land Company. [818]

Mr. Mackay: For their purposes, maybe. Of course, whether that is right or not, I think it is entirely irrelevant and immaterial and has no bearing upon the values here.

The Court: Well, I am inclined to think that it may have some materiality, in view of the testimony which has been adduced with reference to the discount to be applied to evaluating minority interests. It may have some materiality.

Mr. Mackay: May I interrupt the court to make a further objection to it, unless the voting trust to which it refers is brought forth.

Mr. Melville: No objection, your Honor. We are not trying to withhold any evidence.

Mr. Mackay: I don't want it introduced as my exhibit, if your Honor please.

The Court: I think we can properly receive it,——

Mr. Mackay: I want the record to show——

The Court: ——as part of the whole transaction, so that we will receive these three documents. I think I will mark notice of special meeting of stockholders of the Carson Estate Company as Respondent's Exhibit II, and the document containing the minutes of May 6, 1936, of the Carson Estate Company as Respondent's Exhibit JJ, and in order to complete the record the voting trust agreement relative to [819] capital stock of the Francis Land Company as Exhibit KK.

Mr. Mackay: May the record show an objection to each one of those on the ground that they are irrelevant and immaterial.

The Court: The objection will be overruled.

(Thereupon, the documents referred to were marked as Respondent's Exhibits II, JJ, and KK, respectively, and were received in evidence.)

[Respondent's Exhibits II, JJ, and KK set out in full in Book of Exhibits.]

Mr. Mackay: Please note an exception.

The Court: Exception may be noted.

Mr. Melville: Your Honor, I have copies that were made for me by Mr. Arnold giving extracts

from the minutes of the Reyes-Dominguez Company, which meetings were held on December 12, 1935, and April 9, 1936.

Mr. Mackay: Wait a minute, Mr. Melville, until I can follow you.

Mr. Melville: May 13, 1936, and September 11, 1936. I offer those in evidence.

Mr. Mackay: If your Honor please, I object on the ground it is irrelevant and immaterial.

The Court: I am not sure that I recollect anything about the Reyes-Dominguez Company. We have been, it seems to me dealing in this case with the Dominguez Company.

Mr. Melville: That is correct, your Honor.

I might state that before I am through offering [820] documents here I will offer a stipulation of facts which I think will clear up the relationship of the Reyes-Dominguez Company.

The Reyes-Dominguez Company was an organization that among other things purchased 1,100 shares of Dominguez Company stock from the Title Insurance & Trust Company—or pardon me, from the O'Melvenys, and 365 shares of Francis Land from the Title Insurance & Trust Company trust of Mrs. Francis.

The Court: Well, it may be that the whole matter will be connected. I was only making the observation that I hardly knew the connection.

Suppose we mark the document at this time for identification as Respondent's Exhibit LL, and I will see if I can more intelligently rule upon the offer when I know more about it.

(The document referred to was marked for identification as Respondent's Exhibit LL.)

Mr. Melville: Your Honor, I have a document here which contains extracts from the minutes of the directors' meeting of the Dominguez Estate Company, which meetings were held on April 10, 1935, June 19, 1935, May 7, 1936, May 13, 1936, May 25, 1936, but inasmuch as I have only asked for extracts from those minutes and Mr. Mackay says if they go in at all he would prefer to have the entire minutes, I have here the entire minutes of May 25, 1936, and July 29, 1936, and I offer in evidence both documents as respondent's next exhibit.

The Court: They may be marked for identification as Respondent's Exhibit MM.

Mr. Mackay: Just for identification.

The Court: Very well, mark them for identification as Respondent's Exhibit MM, and perhaps to keep them separate we had better mark that document as prepared by counsel for the Government MM-1 and the document supplemental to it as MM-2. You had something to say, Mr. Mackay?

Mr. Maackay: My only point is that I had merely asked counsel to put in all the minutes with respect to May 25th. I don't want the record to infer that I am offering them in evidence.

The Court: I think I understand, and I don't believe you will be charged with anything. You probably are in the position that you object to receiving a portion of the minutes for that year. [822]

Mr. Mackay: That is right, rather than suggesting that any meetings——

The Court: You think it should be the whole.

Mr. Mackay: That is right. I just want to be sure my objection goes to that.

The Court: I think I understand your objection. I mean, I think the record is clear on that. But we will identify MM which consists of two parts, MM-1 and MM-2 as identified.

(The documents referred to were marked for identification as Respondent's Exhibits MM-1 and MM-2.)

Mr. Melville: Your Honor, at this time I offer a stipulation, the original and two carbon copies thereof, and attached to the original and to one carbon copy are three invoices. The stipulation is a stipulation entered into by Mr. Mackay and counsel for the respondent dealing with certain sales of the various stocks that are involved in this case.

Mr. Mackay: If your Honor please, I entered into this stipulation, reserving the right to object to the statements and to the stipulation on the ground of irrelevancy and immateriality.

The Court: In other words, the essence of your objection. I take it, would be that you admit that the facts are facts, but that they have no materiality to the controversy.

Mr. Mackay: That is right, irrelevancy. [823]

The Court: Or relevancy. The stipulation may be handed to the Clerk, will be filed of this date and will constitute a part of the record.

Mr. Mackay: Please note an exception.

The Court: Why would you except to that ruling?

Mr. Mackay: Well, maybe I didn't understand your Honor.

The Court: You prepared and handed me a stipulation and I only received it for filing as part of the record.

Mr. Mackay: Oh, I see. Well, I want the record to show that I object to the relevancy and materiality of what is stipulated.

The Court: I am not ruling upon either.

Mr. Mackay: I see.

The Court: I will have to reserve that until I analyze it and see.

Mr. Mackay: That is quite agreeable.

Mr. Melville: I will call Mr. Hill.

HARRY K. HILL,

called as a witness for and on behalf of the respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

The Clerk: Your name for the record, please.

The Witness: Harry K. Hill.

By Mr. Melville:

Q. Mr. Hill, what is your business?

A. Certified public accountant.

Q. How long have you been engaged in that business?

A. In public accounting since 1920.

(Testimony of Harry K. Hill.)

Q. Here in Los Angeles? A. Yes, sir.

Q. Did you ever do any accounting work for the Dominguez Estate Company?

A. Yes, sir.

Q. The Francis Land Company?

A. Yes, sir.

Q. The Carson Estate Company?

A. Yes, sir.

Q. When did you discontinue doing the accounting work for those companies?

A. Well, for Carson Estate Company I can't recall. It must have been in 19—probably in 19—about 1925. That is—well, around 1925 or 1926. I don't recall exactly,—

Q. Well, Mr. Hill, did you work for, do accounting work for the Dominguez Estate Company since the O'Melvenys were not connected with it?

A. Yes, sir.

Q. And for any length of time thereafter? [825]

A. Well, I did some work after—after I suppose they were not connected with the company, yes, sir.

Q. You knew Mr. H. W. O'Melveny?

A. Yes, sir.

Q. Did he ever call upon you to furnish him with financial statements of the condition of the Dominguez Estate Company? A. Yes, sir.

Mr. Mackay: I object. Oh, you answered that?

The Witness: I said yes, sir.

By Mr. Melville:

Q. Did he call on you for financial statements

(Testimony of Harry K. Hill.)

during 1935 and during the spring of 1936?

Mr. Mackay: I object to that, if your Honor please. It is a suggestive question in the first place, and besides it is irrelevant and immaterial.

The Court: Well, I am a little bit confused as to the years. I thought he was talking about 1925. He said 1925 a while ago.

Mr. Melville: He said, your Honor, that he did some work for the Carson Estate Company in 1925. The record will show, the stipulation that we have filed, your Honor, will show that the O'Melvenys were put out in long about May 8, 1936, and this witness has testified that he did accounting work for the Dominguez Estate Company up to and including that [826] time and for a short period of time thereafter.

Mr. Mackay: Now, if your Honor please, I want the record to be unchallenged and free of question. If we go into the O'Melvenys it is a long story, and the facts are stipulated. I think that will be enough to protect my record.

The Court: Well, I had not understood him to say that he had been in the work of accountant for these companies in 1936. But that is a fact that you were, is that correct?

The Witness: That is correct, yes.

The Court: Very well.

Mr. Melville: What was the last question? Has it been answered?

The Court: The question was whether he had

(Testimony of Harry K. Hill.)

prepared some reports in 1936. Did you want all the question read back?

Mr. Melville: I believe we had better have it to show what has been ruled upon.

(The question was read.)

Mr. Mackay: I object to it on the ground it is incompetent and irrelevant and immaterial, what this accountant did in 1936 for H. W. O'Melveny.

The Court: I don't know how competent it may be. We are dealing here with the years much later, but if it is not connected up we will, of course, ignore it. You may proceed with the examination. He may answer yes or no. [827]

The Witness: Yes.

By Mr. Melville:

Q. Do you of your own knowledge know whether Mr. O'Melveny kept constantly abreast of the financial condition of the Dominguez Estate Company?

Mr. Mackay: If your Honor please, I object to that as a suggestive question in the first place, and besides it is entirely irrelevant and immaterial. He is not in a position to state the condition of the mind of Mr. O'Melveny whether he was abreast or whether he was away off. Whether he was away off or whether he was abreast is not personally known to him.

The Court: The objection will be sustained to the question as phrased.

(Testimony of Harry K. Hill.)

By Mr. Melville:

Q. Did you have discussions with Mr. O'Melveny or he with you about the value of the Dominguez Estate Company stock? A. Yes.

Q. When?

A. Well, at various times over a period of years. I couldn't tell you the dates.

Q. You know, do you not,—excuse me. I will withdraw that.

Mr. Mackay: Thank you, Colonel.

By Mr. Melville: [828]

Q. Mr. Hill, what was the nature of the reports that you gave Mr. O'Melveny?

Mr. Mackay: I object, if your Honor please, entirely incompetent, irrelevant and immaterial to anything in this case.

The Court: In a general way he may state the nature of the reports.

Mr. Mackay: Maybe I am anticipating. I think you are right.

The Witness: Well, largely—at the end of the month he was given a statement, what we call a balance sheet, a profit and loss statement, and those were statements made according to the books and according to the records that we had.

By Mr. Melville:

Q. Did he continue to receive those statements as long as he remained connected with the Dominguez Estate Company?

(Testimony of Harry K. Hill.)

A. Well, I would like to—I couldn't say that it was our practice to make them every month, but it is possible that there may have been occasions when they were not made exactly at the end of the month, and on the other hand, frequently we made special reports for him and for the company.

Q. Do you know whether or not he received such a report of the condition of the Dominguez Estate Company at the time that the sale of 1100 shares of the Dominguez Estate Company [829] stock to the Reyes-Dominguez Company was being considered?

Mr. Mackay: I object to that, if your Honor please, as a leading question. It is also suggestive and besides it is irrelevant and immaterial.

Mr. Melville: Your Honor, the purpose of this question is material. The record will show that there was a sale of 1100 shares of Dominguez Estate Company stock from the O'Melveny family to the Reyes-Dominguez Company at \$1000.00 per share. I want the record to show that that was not some figure picked out of thin air, as one of the petitioners' expert witnesses said, and I want to show that the figure was based upon facts which Mr. O'Melveny knew, and that he was well familiar with the financial condition of those companies.

Mr. Mackay: If your Honor please, if that was the purpose, then, of course, that is clearly objectionable and I certainly do object on the ground that it is incompetent, irrelevant and immaterial.

The Court: I am not sure that I understand just

(Testimony of Harry K. Hill.)

what you are attempting to go into. I think I would permit you to show the general practice as it existed along at the time the sale was made, of furnishing to the seller or to someone connected with these companies comparative statements or balance sheets, receipts and disbursements and profit and loss, but I don't think that it would be competent to receive those documents themselves in evidence. [830]

Mr. Melville: I am not offering those, your Honor.

Mr. Mackay: I asked him to direct this witness how he arrived at that, what he did and how he determined it.

Mr. Melville: This is a certified public accountant doing work for the O'Melvenys.

The Court: Let us hear the last question, please, Mr. Reporter.

(The question was read.)

The Court: Well, do you know when the sale that counsel is referring to took place?

The Witness: The exact date, no, I don't. I know all about it, approximately it was in 19—sometime in 1936. I would say that it was sometime in May or June, but I can't remember the exact date, and as a matter of fact, I don't know that I ever did know the exact date.

The Court: Well, in a general way, I will permit you to answer the question, as to whether you

(Testimony of Harry K. Hill.)

were still giving balance sheets of those reports along about the time when the sale was made, if one was made.

The Witness: Yes.

Mr. Melville: No more questions.

Mr. Mackay: That is all.

The Court: You may stand aside, Mr. Hill.

(Witness excused.)

Mr. Melville: Will you take the stand please, Mr. [831] Cotton. I would like to resume my direct examination.

The Court: This witness was sworn before, wasn't he?

Mr. Melville: Yes, your Honor.

The Court: And testified. Very well.

HENRY HAMILTON COTTON,

recalled as a witness for and on behalf of the Respondent, having been previously duly sworn, was further examined and testified as follows:

Further Direct Examination

The Court: Now, let me see. On the record we are doing what? Have you called the witness for further cross examination?

Mr. Melville: The witness that I stopped, on your Honor, at one time, because I had an expert witness waiting in Court, and asked leave to defer his examination, as you recall.

(Testimony of Henry Hamilton Cotton.)

Mr. Mackay: To clear up the record, Mr. Cotton was called by counsel for the Respondent.

Mr. Melville: That is right, and I am renewing the direct examination.

The Court: Then he is your witness?

Mr. Melville: Yes, your Honor.

The Court: Very well. [832]

By Mr. Melville:

Q. Mr. Cotton, referring to the voting trust agreement which the Watson Land Company and the Carson Estate Company entered into during 1936, did that voting trust agreement remain in effect throughout 1941? A. Yes, sir.

Q. Referring, Mr. Cotton, to the minutes of the directors' meeting of the Dominguez Estate Company dated May 25, 1936, wherein it was decided to put up for consideration of the stockholders the matter of purchasing not to exceed 499 shares of the stock at a price not exceeding \$1000.00 per share, I ask you, Mr. Cotton, if the stockholders met on May 25, 1936, and if so, whether or not they approved that plan?

Mr. Mackay: Now, let me get the question. Was that with respect to the reduction of the stated capital, Mr. Melville?

Mr. Melville: That was one of the points that was taken up at that special meeting.

Mr. Mackay: Yes.

Mr. Melville: I may state, your Honor, that the minutes of the directors' meeting show that they

(Testimony of Henry Hamilton Cotton.)

called a special meeting of the stockholders, but there is not in the book any record of the stockholders' meeting, although the directors met on the same day, May 25th, and proceeded as though there had been a stockholders' meeting. I just want [833] to clear it up, as to whether or not there was a stockholders' meeting pursuant to that plan and what action they took.

The Court: You mean the stockholders' meeting? May I just get it straight in my own mind? Do you mean the stockholders' meeting to reduce this stated capital, or do you mean regarding the purchase of shares? I am becoming a little confused there. We may be off the record a moment.

(Discussion off the record.)

The Court: Are we ready to proceed, gentlemen?

Mr. Melville: Yes, your Honor.

By Mr. Melville:

Q. Referring, Mr. Cotton, to the minutes with respect to the possible purchase of 499 shares of stock at \$1000.00 per share——

A. Not exceeding.

Q. ——not exceeding \$1000.00 per share, thank you, did you ever hold a meeting of the stockholders with respect to the purchase of those shares of stock?

A. We never did, and we never purchased any.

Mr. Melville: Thank you. You may cross examine.

(Testimony of Henry Hamilton Cotton.)

Your Honor, this is the last witness which Respondent is calling, and before I turn him over to Mr. Mackay for cross examination of this witness, I will resume my offer in evidence of what has been marked as Respondent's Exhibits LL, MM-1 and MM-2. [834]

Mr. Mackay: Let's offer just one at a time, so I can get the record clear.

Mr. Melville: I offer at this time Respondent's Exhibit LL.

Mr. Mackay: If your Honor please, I object to that as irrelevant and immaterial.

The Court: Well, I don't know whether it has any relevancy or materiality. I will have to dovetail it in with these minutes which have been received, and which I have, of course, not had an opportunity to examine. I will, however, overrule an objection and receive it for what materiality, if any, and relevancy it may have or be determined to have when we go to inquiring into the whole matter.

Mr. Mackay: That is quite agreeable.

The Court: So we will receive the document which has heretofore been marked for identification as respondent's Exhibit LL.

(The document which was heretofore marked as Respondent's Exhibit LL for identification, was received in evidence.)

[Respondent's Exhibit LL set out in full in Book of Exhibits.]

(Testimony of Henry Hamilton Cotton.)

Mr. Melville: At this time I want to resume my offer of what has been marked for identification as Respondent's Exhibit MM-1.

Mr. Mackay: Same objection, your Honor.

The Court: Same ruling. [835]

(The document heretofore marked as Respondent's Exhibit MM-1, for identification, was received in evidence.)

[Respondent's Exhibit MM-1 set out in full in Book of Exhibits.]

Mr. Melville: And in view of Mr. Mackay's statement that he wanted the entire minutes of May 25, 1936, to go in, I will offer as Respondent's Exhibit MM-2 what has been heretofore marked as Respondent's Exhibit MM-2 for identification.

The Court: Well, it will be received. I think I understand counsel's objection, namely, that if certain portions of MM-1 are to be received, that MM-2 too should be received rather than a page or so of MM-1.

Mr. Mackay: That is right, your Honor. I just don't want——

The Court: Objection overruled. You are not being charged with the responsibility of offering MM-2, but merely as objecting to the receipt of a portion, or MM-1.

Mr. Mackay: That is right.

The Court: And you are offering the same objection heretofore made with reference to LL. Both documents will be received in evidence.

(Testimony of Henry Hamilton Cotton.)

(The document heretofore marked as Respondent's Exhibit MM-2, for identification, was received in evidence.)

[Respondent's Exhibit MM-2 set out in full in Book of Exhibits.]

Mr. Melville: You may cross examine.

Cross Examination

By Mr. Mackay:

Q. Now, Mr. Cotton, referring to the minutes of the [836] board of directors of the Dominguez Estate Company, dated May 25, 1936, I call your attention to a statement in there in which the chairman states something like this:

"The chairman then read a letter from Del Amo Estate Company addressed to Dominguez Estate Company in which they offered to sell all or any part of their 980 shares of stock in the company for a price of \$800.00 per share."

I will ask you, Mr. Cotton, if the Dominguez Estate Company ever purchased this Del Amo stock.

A. They did not.

Q. Do you know why? A. Yes.

Q. Will you please state to the Court.

A. Because I advised the directors that the price was way out of line and too high. At the same time the directors authorized me to negotiate with the Del Amos as to the price of the stock. After talking it over with Mr. Del Amo, he finally withdrew his offer to sell.

(Testimony of Henry Hamilton Cotton.)

Q. Now, Mr. Cotton, I think you have stated, but I want to make sure, did the Dominguez Estate Company after this authorization in reducing its stated capital in 1936 ever purchase any of its own stock?

A. They did not. Now, I say that advisedly. I am pretty sure they did not. [837]

Q. Mr. Cotton, I call your attention to the report to the stockholders. I think it is dated May—March, 1940—I will reframe the question. I call your attention to Respondent's Exhibit CC, which is a report to stockholders of the Dominguez Estate Company dated March 28, 1940, and I call your attention particularly to the last paragraph of that, and more particularly to the reference to its appraised value, referring to the stock of the Dominguez Estate Company. I will ask you, Mr. Cotton, if there was ever an appraisal made of the stock of the Dominguez Estate Company prior to this suit?

A. Not to my knowledge.

Q. Well, what did you refer to when you were referring there to its appraised value, Mr. Cotton?

A. Well, I think that was rather an unfortunate word, its appraised value. It referred to my—was the figure that was set forth by the Government in their claim for taxes in the Francis Estate and on which tax was paid. That is the only thing we had an appraisal on.

Q. Now, I think you are speaking about the deficiency letter to the Francis Estate.

A. Yes, of 1934, I believe.

(Testimony of Henry Hamilton Cotton.)

Q. In about 1934. I see.

A. And in calling—can I follow up this just a moment—in calling my attention to the last paragraph I see [838] their ability to pay a return of 7.7 per cent on the basis of \$1000.00 per share, ability to pay it not particularly out of earnings but out of previous earnings, and surplus account. It was not out of earnings.

Q. I see. Now, Mr. Cotton, I will ask you to please state whether or not you know Huntzinger & Cosgrove? A. Attorneys, yes.

Q. Will you please state whether Huntzinger & Cosgrove were ever attorneys for the Dominguez Estate Company? A. No, I believe not.

Q. Were they ever attorneys for the Francis Land Company? A. No.

Q. Were they ever attorneys for the Carson Estate Company? A. No.

Mr. Mackay: You may take the witness.

Redirect Examination

By Mr. Melville:

Q. Mr. Cotton, you stated that this 7.7 per cent on the basis of \$1000.00 per share was not paid out of earnings but was——

A. No, I said not entirely out of earnings, but out of earnings and previous earnings and surplus.

Q. Do you have the books of the corporation here that [839] will substantiate your statement?

Mr. Mackay: We stipulated to that.

(Testimony of Henry Hamilton Cotton.)

The Witness: Mr. Arnold, have you any books here?

Mr. Mackay: We have a stipulation here.

Mr. Melville: Yes, but there is nothing stipulated, Mr. Mackay, that shows that they delved into surplus in order to pay the dividends.

Mr. Mackay: Why, sure.

The Court: Pardon me. Does the stipulation of facts show that the amount of dividends paid were in excess of the amount of earnings?

Mr. Mackay: Yes, your Honor.

The Court: Is that what you are referring to, Mr. Cotton?

The Witness: Yes, sir.

Mr. Melville: I think the stipulation will show that. No more questions.

Mr. Mackay: That is all.

At this time, I would like to offer, if your Honor please——

(Witness excused.)

Mr. Melville: Respondent rests.

The Court: So this will now be on rebuttal, will it gentlemen?

Mr. Mackay: Yes, your Honor. [840]

The Court: Very well.

Mr. Mackay: I will state for the record that Joint Exhibit 15-O shows the shareholders of the Carson Estate Company and in order to show their relationship to the Petitioners here we have re-copied Joint Exhibit 15-O and added the relation

to the Petitioner, and I should like to offer that at this particular time.

Mr. Melville: No objection, your Honor.

The Court: Pardon me just a moment. Apparently we have received on behalf of the Petitioners in this case some 28 exhibits; haven't we?

Mr. Mackay: Yes, your Honor.

The Court: So that this then may be marked as Petitioners' Exhibit No. 29, and I suggest that we better strike out of it the words Joint Exhibit 15-O appearing at the top here.

Mr. Mackay: Yes, your Honor. I am sorry. That is quite all right.

The Court: Very well. This will be received. Is there any objection?

Mr. Melville: No, your Honor.

The Court: This will be received as Petitioners' Exhibit No. 29.

(The document referred to was marked and received in evidence as Petitioners' Exhibit No. 29.) [841]

Mr. Mackay: I offer a similar statement with respect to the outstanding stock of the Francis Land Company. You have a copy of that, I think.

Mr. Melville: No objection, your Honor.

The Court: It will be received as Petitioners' Exhibit No. 30.

(The document referred to was marked and received in evidence as Petitioners' Exhibit No. 30.)

Mr. Mackay: And I offer a similar statement with respect to the stockholders of the Dominguez Estate Company.

Mr. Melville: No objection, your Honor.

The Court: It will be received as Petitioners' Exhibit No. 31.

(The document referred to was marked and received in evidence as Petitioners' Exhibit No. 31.)

Mr. Mackay: At this time I would like to call Mr. Wents.

The Court: This gentleman was previously sworn?

Mr. Mackay: Yes, your Honor.

JOHN H. WENTS, JR.

recalled as a witness for and on behalf of the Petitioners, having been previously duly sworn, was further examined and testified as follows:

Further Direct Examination

By Mr. Mackay: [842]

Q. Mr. Wents, have you prepared a map at my suggestion with respect to the drilling of wells on the Dominguez Estate property?

A. Yes, I have.

Q. Will you please explain to the court just what this map is, Mr. Wents?

(Testimony of John H. Wents, Jr.)

A. This is identically the same map as referred to before, with the leases marked on it.

The Court: Identically the same map as one of the exhibits attached to the stipulation of the parties.

The Witness: Yes.

The Court: Do you know which one that is?

We will be off the record a minute.

(Discussion off the record.)

The Court: The record may show that the map which has been placed on the board in the court room is substantially the same as Exhibit 17-Q, is that right, Mr. Wents?

The Witness: It is, your Honor, with the exception that Exhibit 17-Q is exactly to date June 5, 1941, but on this map there are shown certain wells which I will explain later which have been drilled subsequent to the date of June 5, 1941.

Mr. Melville: I object to going into anything that happened subsequent to June 5, 1941, your Honor, because a person appraising this stock as of that date could not possibly know definitely, could not know as definitely as Mr. Wents [843] knows what happened subsequent to June 5, 1941.

Mr. Mackay: If your Honor please, I have not offered the map in evidence yet. I am just trying to lay a foundation.

The Court: Well, I would suggest that—I don't anticipate that you are going to offer that map in evidence, are you?

(Testimony of John H. Wents, Jr.)

Mr. Mackay: I should like to, your Honor, when I lay a proper foundation. I think I can demonstrate in a very few minutes that it is perfectly proper for my limited purpose.

The Court: You may proceed with the examination of the witness.

By Mr. Mackay:

Q. Mr. Wents, I think you testified that there were eight producing zones on the oil properties of the Dominguez Estate Company, did you not?

Mr. Melville: I object, your Honor. He hasn't made it definite when this was.

Mr. Mackay: This is merely preliminary. At the basic date here, June 5, 1941.

The Witness: There were eight zones productive on a part of the lands of the Dominguez Estate Company, not upon all of the lands of the Dominguez Estate Company.

By Mr. Mackay:

Q. What was the lowest, what was the depth of the [844] lowest in these zones.

A. The lowest well?

Q. Yes, if you remember.

A. I think you mean the deepest one.

Q. I should say the deepest well.

A. There had been drilling on the land of the Dominguez Estate Company to a depth of 10,000 feet prior to June 5, 1941.

Q. How many wells had they—I will put it this

(Testimony of John H. Wents, Jr.)

way, had there been wells drilled prior to June 5, 1941, below either one of the eight zones?

A. Yes, there had.

Q. How many wells?

A. On Dominguez Hill as a whole, there were at least 11 wells that had been drilled into the eighth zone, the lower part of the eighth zone or to deeper horizons than the eighth zone as of June 5, 1941. I have not counted them up with respect to the Reyes lease or the Manuel lease or the Selbar lease, but this is with respect to deep drillings on Dominguez Hill.

Q. And how deep do those wells run?

A. The deepest well that had been drilled, that is, the deepest well stratographically that had been drilled was Callender No. 79, which was drilled to a depth of 12,720 feet, I believe.

The Court: Do you remember when that was drilled? [845]

The Witness: That Callender 79 was spudded, that is, drilling commenced as of September 16, 1940, and drilling had been finished by April 21, 1941.

By Mr. Mackay:

Q. With what result?

A. The well, as I said, was drilled to a total depth of 12,720 feet, or approximately 12,700 feet. The well went right down to the formation where the schist was identified in the well. Subsequent efforts to get flow resulted in the well being plugged

(Testimony of John H. Wents, Jr.)

back to 7,490 feet where it was producing from the 7000 and 8000 foot zones combined.

Q. Now, were there any other wells drilled at that date or prior to that date as deep or approximately deep as that No. 79?

A. Well, the Callender No. 15.

Q. Will you mark that on this map?

A. I have marked these well locations.

The Court: You say you have or you have not?

The Witness: I have marked them, your Honor. There is a mark on the special map here, and I think I can point out their respective locations.

The Court: Let me ask you, counsel, the purpose of this additional examination and identification?

Mr. Mackay: Well, I think this is quite important.

The Court: As I recollect—of course, I have been [846] off of this case for a week or so, but as I recollect it you gentlemen have stipulated as to the developments which had taken place on these leases prior to the basic date, and you had also stipulated the probable estimated production from the old field, both in barrels and in dollars. Now, I think the evidence has shown that these wells going down to or below the schist indicated that there had been complete exploration. At least, you gentlemen had agreed upon a probable estimate both for barrels and for money. Now, what purpose is there in going into more detail?

Mr. Mackay: If your Honor please, it is just

(Testimony of John H. Wents, Jr.)

this, and I can see where the Court is a little confused. In one of these many reports to the stockholders there was a statement made to the stockholders that somebody in the Shell Oil Company perhaps had some idea that there were deeper sands in the deeper zones, and I am just offering this in rebuttal of that.

Mr. Melville: Well, your Honor——

Mr. Mackay: In other words, it will only take a few minutes for me to outline the whole procedure. If your Honor please, Mr. Wents is prepared to and if permitted will testify that there were a number of wells drilled prior to the basic date at deeper zones, and that he was of the opinion at that time that there were no productive sands below those zones. He will also, if permitted to testify and show on the map, and there were three wells drilled subsequent to that time, and [847] that I will offer merely for the purpose of trying to confirm his opinion that on that date the lower zones were not productive.

The Court: Well, I have no desire to interfere with the way you try your case. I am just trying to get myself oriented here.

Mr. Mackay: I think that is quite right. I should have explained the purpose for going into this. It will only take a very few minutes.

Mr. Melville: Your Honor, the important thing, as I see it, is to put everyone's mind that has to do with this case, in the way of expert witnesses, I believe, back to June 5, 1941, and look at the pic-

(Testimony of John H. Wents, Jr.)

ture as they at that time saw it or could possibly have seen it. Now, the report of the president of the Dominguez Estate Company to his stockholders, made just shortly prior to that basic date, reveals the facts just as accurately as he could at that time. Now, true, his opinion may have changed since then because of developments subsequent to June 5, 1941, but I do not think such developments subsequent to our basic date have any bearing or relevancy in this case, and I am going to oppose right along any question or any exhibits which would bring into this picture something which was not in the picture on June 5, 1941.

Mr. Mackay: If your Honor please, I want to make myself very clear. The evidence will show that 11 wells were [848] drilled to deeper zones, and that they were dry holes as of that date. We certainly are clearly entitled to show that, particularly in view of the reports which counsel got in over my objection. Now, I am showing that wells were drilled, for no other purpose than as a confirmation—as the Supreme Court has said, you cannot close the book, you can look beyond the basic date for some purposes. The Court set the rule, I think, in the Ford case with Mr. Cousens, where they said that you would have to refer to the basic date, but perhaps you could look beyond it a little. It seems to me this is one case where certainly we should be permitted to show the picture at the basic date.

Mr. Melville: It is not your desire, I am sure,

(Testimony of John H. Wents, Jr.)

to in any way change or effect or color or discolor the stipulated facts in the case?

Mr. Mackay: Not at all, but there is some evidence here, if your Honor please, that somebody thought and it went out in a report to the stockholders that there may have been some deeper zones. I want to prove what the situation was, and I should have that right.

Mr. Melville: All you are proving, then, Mr. Mackay, is that the corporation or the president of the corporation may or may not have thought wrong in April, May or June, of 1941. That is not important.

Mr. Mackay: I think it would be important.

The Court: I guess we are off on a tangent on account of my asking you what I did ask you. Proceed with the examination of the witness and I will rule on any objections.

By Mr. Mackay:

Q. Will you please tell the Court how many wells were drilled prior to June 5, 1941, to a zone deeper than the eighth zone, and will you please give the number? A. 11 wells.

Q. Will you give the numbers of those wells on this map?

A. Yes, with respect to the map which is in evidence and the same numbers prevail.

The Court: Why not put it on this map, then, which is part of the stipulation already? Why put in another map which is the same as the map you have in? It could be indicated on that.

(Testimony of John H. Wents, Jr.)

Mr. Mackay: That could be very easily done. We would have him draw a red line around the circle with a pencil.

The Court: Well, then, we will hand the witness Joint Exhibit 17-Q. Is counsel for the Respondent agreeable to letting the witness indicate on Joint Exhibit 17-Q the well or wells to which he desires to make reference?

Mr. Melville: If they are wells that were drilled prior to June 5, 1941. [850]

The Witness: Yes.

Mr. Melville: No objection.

The Court: Very well. You may indicate it on this map. Can you use it here?

The Witness: Yes, sir, this is Callender 79.

The Court: He has indicated on—what is that—the Reyes lease?

The Witness: No, this is the Union Oil Callender lease, Callender well No. 79. Then on the Union Oil Company Callender lease, Callender well No. 50, then on the Republic Petroleum Company Childs lease, Childs No. 3. Then on the Shell Oil Company, upon the Manuel lease of the Shell Oil Company, Manuel well No. 7. Then on the Selbar Stabler lease, Morton & Elder, well No. 1. Then on the Reyes lease, Reyes No. 90. Then on the Shell Oil Company Reyes lease, well No. 95. Then on the Reyes lease, well No. 97, Shell Oil Company. Then well No. 100 on the Shell Reyes lease. Then well 109 on the Shell Reyes lease. Drilling on well No.

(Testimony of John H. Wents, Jr.)

110, Shell Oil Reyes, 110 had been commenced but the well had not been completed.

The Court: You have indicated on the map the completed wells, is that right, Mr. Wents?

The Witness: Upon which drilling had been completed on or before June 5.

The Court: For the sake of the record I wish to [851] state that the Court has indicated by a circle with a number in it on the map just above the circle drawn by the witness the numbers which coincide to his testimony, namely, 1, 2, 3 and so forth through No. 10, so that the figures appearing on this exhibit are in the handwriting of the Court rather than of the witness and are put there for the purpose of identifying the marks put by the witness.

Mr. Mackay: Yes, that is agreed.

By Mr. Mackay:

Q. Now, how many wells were drilled since that time?

Mr. Melville: I object, your Honor, on the ground that anything subsequent to the basic date of June 5, 1941, could not possibly influence anyone's opinion if they were honestly putting themselves back to our basic date.

Mr. Mackay: I submit——

The Court: The objection will be overruled. He may answer how many wells were drilled since.

The Witness: At least six.

By Mr. Mackay:

Q. And with what result?

(Testimony of John H. Wents, Jr.)

A. None of them proved to be productive in zones lower than the eighth zone. No wells proved to be productive in zones below the eighth zone.

Q. Did I understand you to say that none of the 11 wells drilled prior thereto proved productive?

A. In the instances of the 11 wells that I mentioned at first, a good number of those wells were completed as successful producers, but were plugged from their biggest—lowest depth.

Q. Yes, that is what I mean.

A. By plugging them back, we were able to successfully complete the wells in a zone higher than that sought.

Q. I see.

Mr. Mackay: That is all.

Cross Examination

By Mr. Melville:

Q. Prior to June 5, 1941, how many wells in the Dominguez field had been drilled to the schist?

A. One well.

Q. Isn't it true, Mr. Wents, that in the Torrance field two wells had been drilled to the schist before 1928?

A. I would say there were probably more than two in the Torrance field drilled to the schist before 1928.

Q. Subsequent to 1928, they found oil in the Torrance field in spite of the fact that they had previously drilled to the schist, is that true?

(Testimony of John H. Wents, Jr.)

A. The Torrance field was discovered and was drilled up to a high degree prior to 1928.

Q. But, Mr. Wents, subsequent to drilling to the schist in the Torrance field, didn't they successfully [853] penetrate to deeper sands in other parts of the field and find oil? A. Yes.

The Court: I am sorry to interrupt you, but I desire to make a telephone call. We will take a brief recess. Excuse me, Colonel.

(A short recess was taken.)

The Court: You may proceed.

By Mr. Melville:

Q. Mr. Wents, there was a well brought in on our basic date, June 5, 1941, a successful well, was there not?

A. I don't know. You would have to refresh my memory with respect to that specific well. I can check very easily, but I don't remember the completion dates on each of the 140 wells on the Reyes lease.

Q. During the conference that we have had in this case preparatory to the trial, haven't we discussed the very significant or unusual fact that on that very day, June 5, 1941, a well was brought in?

A. I don't remember it.

Mr. Mackay: Will you mention the well?

The Witness: If you will mention the well, I can check. If it is a deep well I can check exactly on the completion date.

(Testimony of John H. Wents, Jr.)

By Mr. Melville: [854]

Q. I am not sure whether it was in the Torrence field or on the Reyes lease.

A. Well, we only have about 400 wells that I look after. I am sure I couldn't answer, unless you could name the specific well, then I might remember it.

Q. I don't want to take up the time of the Court to have you go through your records and refresh your memory. I ask you, however, if during 1941 there were not about 20 wells brought in in the Reyes lease?

A. Producing from upper zones.

Q. And you have already testified, I believe, that the fact that you drilled to the schist in one part of the field does not preclude you from drilling in another part of the field and getting oil even at a deeper level.

A. My testimony was not to that effect, and that is not in my own mind. I did not make that statement.

Q. Mr. Wentz, is the schist flat like this table?

A. No, it is not.

Q. Isn't it rolling or perhaps similar to mountains?

A. Undulating, it might be.

Q. What? A. Undulating.

Q. So the mere fact that you would strike the schist if you drilled here in a field does not have any bearing whatsoever on whether you might bring

(Testimony of John H. Wents, Jr.)

in a perfectly good well if [855] you drilled to the same depth over here, does it?

A. It may or it may not.

Q. That is the reason why you drilled 11 wells to the schist, because there was that possibility?

A. I did not testify that 11 wells had been drilled.

Q. I am sorry, I cannot hear you.

A. I did not testify 11 wells were drilled to the schist. I said 11 wells were drilled in the eighth zone or deeper.

Q. Let's talk about the 11 wells. What developed after you drilled the 11 wells?

A. I don't understand the question.

Q. What was the result of those 11 wells that were drilled that you testified about?

A. Of the 11 wells which were drilled, approximately 10 of them were successfully completed by plugging back into either the upper part of the eighth zone or into the seventh, sixth, fifth or the fourth zones, each of those zones occurring successively higher in the column.

Q. Did all the 11 go to the schist?

A. No, I didn't testify that all 11 went to the schist.

Q. How many of these 11 wells went to the schist?

A. One of those 11 wells went to the schist. However, there are other factors which govern.

Q. You have answered my question. [856]

Mr. Mackay: I think he can explain it, your Honor.

The Witness: Non-productivity of a deeper sand

(Testimony of John H. Wents, Jr.)

or the deeper sands having permeabilities and porosity—there might be oil saturations, but with very low permeabilities. We found that took place in excess of 8000 feet of the Dominguez Hill. We have not been able to complete wells successfully. We have certain wells that are as completed as low, I think, as 8400 feet, but our production from these wells is of a magnitude that it is uneconomic to drill them.

By Mr. Melville:

Q. Were the wells in the Dominguez Hill and more specifically the wells in the Reyes lease under curtailment during 1941?

A. Certain of the wells on the Reyes lease were under curtailment during 1941 for the entire period, that is, from, say, January 1st, 1941, to June 5th. Others of them, however, produced at or near their capacity.

Q. Those that were curtailed, will you please state the amount that was permitted under the curtailment?

A. I do not have the records available. However, in our stipulation, the stipulation was related to the effect of capacity productions.

Q. Isn't it a fact, Mr. Wents, that any time a well is under curtailment, the barrels per day method of appraising the value of the oil royalties is a felonious or very [857] inaccurate method?

Mr. Mackay: I object to that, if your Honor please, as not proper cross examination. I never went into that.

(Testimony of John H. Wents, Jr.)

The Court: Overruled. He may answer.

The Witness: The barrel per day method of appraising oil royalties is, in my estimation, one of the means of checking, because commonly in the purchase of an oil royalty or appraisal of an oil royalty all you are dealing with is barrels of oil for future delivery, and when those barrels have been arrived at, then it is the reduction of your barrels to dollars and the dollars by deferment, and so forth. As far as checking the accuracy of an appraisal, if you are dealing with curtailment of a magnitude that is almost equal to the spot supply, you know that there are certain limits to which you could go or certain appraisal limits to which you could go to reduce the royalty and be safe and not spend your money foolishly. That is the purpose of using that means. It is just a check.

Q. Do I understand your answer to be that the barrels per day method is erroneous or a poor measure when you are dealing with a well that is under curtailment?

Mr. Mackay: I submit, if you Honor please, the question and the answer must stand.

Mr. Melville: As I listened to his answer, I didn't understand the way he was answering my question.

Mr. Mackay: If your Honor please, he asked him about felonious in the first place, and I think the question has been answered.

Mr. Melville: I am sure it has not.

The Court: I rather thought that it had, but

(Testimony of John H. Wents, Jr.)

we will permit him to answer it again, if counsel thinks it was not answered.

The Witness: In speaking of an individual well, I would say if it was curtailed completely to zero that the barrel per day method would be a very poor method of appraising that particular well.

By Mr. Melville:

Q. How about if it was curtailed 50 per cent?

A. If curtailed to 50 per cent, then the figure that would be used by the adoption of the adoption of the barrel per day method of appraisal would be a higher figure than you could justify using if it was producing wide open. So is is a case of judgment on the part of the appraiser as to how he can use a series of figures.

Q. Yes. I understand your testimony to be that if an appraiser is going to use the barrel per day method as a means of appraising the value of oil royalties, he must necessarily know the percentage of curtailment, isn't that right?

A. Yes, that is right.

Mr. Melville: No more questions. [859]

Mr. Mackay: That is all.

The Court: Stand aside, Mr. Wents.

(Witness excused.)

Mr. Mackay: That is all, your Honor. The Petitioner rests.

Mr. Melville: The Respondent rests.

The Court: That completes the trial of these cases, does it?

Mr. Mackay: Yes, your Honor. We are very happy to bring it to a termination.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

I take it you gentlemen will desire to file briefs.

Mr. Mackay: Yes, your Honor.

The Court: I will allow you a little extra time because we have a long record.

Mr. Mackay: If your Honor please, I would suggest—I would like to ask a longer time. We are very busy, and we do not get our transcripts for at least 20 days and sometimes a little longer, so I would think that 75 days ought to be allowed us for that purpose, for the Petitioners' brief.

The Court: I will allow you that.

Mr. Melville: I would like to have the reply brief within 50 days thereafter, your Honor. [860]

The Court: Well, let's make it 45 or 60. Which would you rather have?

Mr. Melville: I will take the 60 and try to get in in 45.

The Court: Very well. The schedule then will be, Petitioner will have 75 days from this date within which to file the opening brief, then Respondent will have 60 days within which to file the answer brief, and the Petitioner will have 30 days within which

to file reply brief, and the proceeding will stand submitted on that basis. Thank you, gentlemen.

(Thereupon, at 5:10 p. m., October 19, 1945, the hearing in the above-entitled matter was closed.)

Filed Nov. 13, 1945. [861]

The Tax Court of the United States
Docket No. 2257

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 7583.

VIRGINIA CALDWELL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STIPULATION

It is hereby stipulated and agreed by and between the parties hereto, through their respective counsel, as follows:

(1) That the above entitled proceeding may be,

and they hereby are consolidated for hearing, consideration and opinion;

(2) That the oral and documentary evidence and stipulations of facts received in the case of Victoria L. Cotton, Docket No. 2257, shall be deemed to have been received in the case of Virginia Caldwell, Docket No. 7583;

(3) That for the purposes of this proceeding any reference to the date of June 5, 1941, and any valuations as of that date shall be applicable without change, to the date August 11, 1941, and that the [862] fair market value of any assets stipulated or determined by the Court as of June 5, 1941, shall be deemed to be the fair market value thereof as of August 11, 1941.

/s/ A. CALDER MACKAY,
/s/ ARTHUR MCGREGOR,
/s/ HOWARD W. REYNOLDS,
/s/ ADAM Y. BENNION,
Counsel for Petitioner.

/s/ J. P. WENCHEL, RHN,
Chief Counsel Bureau of
Internal Revenue.
Counsel for Respondent.

Filed Oct. 8, 1945. [863]

United States Circuit Court of Appeals for the
Ninth Circuit

Tax Court Docket No. 2257

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REVIEW OF DECISION OF
THE TAX COURT OF THE UNITED
STATES

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Comes now Victoria L. Cotton, petitioner herein, and respectfully shows:

I.

Nature of the Controversy

Respondent determined a deficiency in gift taxes against petitioner for the calendar year 1941 in the sum of \$7,845.75. This deficiency arose because the respondent had increased the value of the gift.

Petitioner filed an appeal with The Tax Court of the United States, which appeal was consolidated for trial and opinion with the appeal of Virginia Caldwell, a related case involving a deficiency in gift tax of \$18,645.51 for the year 1941.

The cases were tried at Los Angeles, California, during the week of October 8, 1945, before the Hon-

orable Arthur J. Melloitt, Judge [864] of the Tax Court of the United States. Thereafter, and on December 8, 1945, Judge Melloitt resigned, and the Honorable Byron B. Harlan thereafter was appointed Judge of the Tax Court of the United States and was assigned this case.

Under date of July 22, 1946, The Tax Court of the United States promulgated its Memorandum Findings of Fact and Opinion, whereupon, on the 19th day of August, 1946, petitioner filed with The Tax Court of the United States a Motion for Rehearing, the grounds therefor being principally that the Judge (Judge Melloitt) who heard the evidence took no part in deciding the case.

As an alternative to this motion, petitioner filed a Motion for Reconsideration. As an alternative to the two foregoing motions, petitioner filed a Motion for Review of Report by the Full Court.

These motions were denied, the first two on the 20th day of August, 1946, and the third on the 21st day of August, 1946. Thereafter and on November 12, 1946, The Tax Court of the United States entered its decision that there was a deficiency in gift tax due from petitioner for the year 1941 in the sum of \$5,214.00.

The controversy involves a determination of the fair market value on June 5, 1941, of 200 shares of the capital stock of Carson Estate Company which petitioner on that date gave to her children. In her gift tax return for 1941 petitioner placed

a value on said stock of \$250.00 per share, or \$50,000.00 for the 200 shares. The respondent in his notice of deficiency valued said stock at \$600.00 per share, or \$120,000.00 for the 200 shares.

The 200 shares of stock of Carson Estate Company given away by petitioner represented 2.7 per cent of the total outstanding stock of that company. [865] The Carson Estate Company owned stocks, bonds, real estate, and some oil properties. Among the stocks it owned were 1,785 shares of the Francis Land Company, which in turn owned approximately 52.4% of the outstanding stock of the Dominguez Estate Company. The Dominguez Estate Company was an operating company owning substantial lands located in the County of Los Angeles, State of California, part of which were oil producing. These oil producing lands had been leased to the Shell Oil Company, the Union Oil Company, and other important producers.

In compliance with the rule of The Tax Court of the United States that facts be stipulated to the fullest extent, the parties agreed by stipulation as to the fair market value of all the underlying assets of the Carson Estate Company and the Dominguez Estate Company except the oil properties of the Dominguez Estate Company. The oil properties owned by the Carson Estate Company were rather insignificant. However, the oil properties of the Dominguez Estate Company were very substantial and it was the value of these oil properties which was the principal subject of controversy.

In order to shorten the time of the trial the parties entered into a stipulation agreeing to the estimated probable future production (in barrels) and the estimated royalty shares (in barrels) of Dominguez Estate Company, and also agreeing to the estimated probable future royalty income. Petitioner presented the expert testimony of two witnesses regarding the value of the oil royalties, and their opinions were \$2,701,361.00 and \$3,000,000.00 respectively. Respondent presented the expert testimony of five witnesses on this question, two of whom expressed an opinion of \$4,000,000.00, one \$4,330,255.00, one \$4,460,000.00, and the other did not express an opinion in dollars and cents. [866]

Judge Harlan, who did not hear the witnesses, found as a fact and determined that the value of the oil properties of the Dominguez Estate Company on June 5, 1941, amounted to \$4,500,000.00. In so doing he assumed that a witness called by petitioner on the question of the valuation of the stocks (Mr. Eitner) had testified that the oil properties had a value of \$4,988,600.00, whereas said witness had not been asked to, nor did he, express an opinion with respect to the oil properties; and Judge Harlan also gave credence to the testimony of two other witnesses called by respondent (Mr. Phillips, \$4,934,391.00, and Mr. Grimes, \$4,819,070.00), who admittedly were not oil engineers and had no familiarity with the oil properties in question.

A value of \$4,500,000.00 for the oil properties,

when added to the stipulated value of the other assets owned by Dominguez Estate Company, resulted in total net assets, divided by the number of shares of stock outstanding, of \$902.91 per share. Judge Harlan found and determined that the value of the Dominguez Estate Company stock was \$900.00 per share.

Five expert witnesses called by petitioner and one expert witness called by respondent on the question of stock valuation testified that even the marketable securities of the most liquid companies were selling on June 5, 1941, at substantial discounts below the fair market value of their underlying assets. Petitioner's witnesses valued the stock of Dominguez Estate Company at from \$304.00 to \$420.00 per share; and said witness for the respondent valued the stock at \$759.00 per share.

Two other witnesses called by respondent admitted that they had valued the stock by dividing the number of shares outstanding into the value of the company's assets as determined by them. One expressed the opinion of \$861.46 per share, although he testified that on an [867] earnings basis the stock would be valued at only \$709.05 per share; the other testified to a figure of \$933.31 per share.

The earnings of Dominguez Estate Company amounted to approximately \$48.00 per share during 1940 and 1941; and uncontradicted evidence, based upon the stipulation of probable future oil income, was presented by petitioner that the earnings for

the succeeding ten-year period, after depletion, would not exceed \$30.00 per share. Witnesses for both parties testified that the stocks of the very best companies and of comparable companies were selling at from seven to ten times earnings.

A value of \$900.00 per share for the stock of Dominguez Estate Company is equivalent to 20 times its current earnings and 30 times its expected earnings over the succeeding ten years.

Judge Harlan reflected the determined value of \$900.00 per share for the stock of Dominguez Estate Company upon the balance sheet of Francis Land Company, which resulted in a net asset value for the Francis Land Company stock of \$989.40 per share. Judge Harlan found and determined that the fair market value of the stock of Francis Land Company was \$990.00 per share on June 5, 1941. He followed the same procedure with respect to the Carson Estate Company stock, finding a value thereof in the amount of \$500.00 per share.

Petitioner avers that in the record and proceedings before The Tax Court of the United States, in the denial of petitioner's motions and in the opinion and decision rendered by The Tax Court of the United States manifest error occurred and intervened to the prejudice of petitioner, who now assigns the following points on which petitioner intends to rely in this proceeding:

The Tax Court of the United States erred: [868]
(A) In determining and deciding without any

evidence or substantial evidence in support thereof a value of \$900.00 per share for the stock of Dominguez Estate Company.

(B) In determining and deciding without any evidence or substantial evidence in support thereof a value of \$990.00 per share for the stock of Francis Land Company.

(C) In determining and deciding without any evidence or substantial evidence in support thereof a value of \$500.00 per share for the stock of Carson Estate Company.

(D) In denying petitioner's Motion for Rehearing.

(E) In denying petitioner's Motion for Reconsideration.

(F) In denying petitioner's Motion of Review of Report by the Full Court.

(G) In finding and deciding that Dominguez Estate Company was a holding company.

(H) In finding and deciding that Dominguez Estate Company was not an operating company.

(I) In failing to find and decide that Dominguez Estate Company was an operating company.

(J) In finding and deciding without any evidence or substantial evidence in support thereof that the fair market value of the oil properties of Dominguez Estate Company was \$4,500,000.00.

(K) In failing to take into consideration the fact that the oil properties of Dominguez Estate

Company sought to be valued were of a speculative nature necessitating the consideration of speculative matters, and in failing to take into consideration all elements and factors, speculative and otherwise, that affect such value. [869]

(L) When determining the fair market value of the oil properties of Dominguez Estate Company, in failing to take into consideration:

- (1) Comparative sales of oil royalties.
- (2) Established and approved methods of determining such values.
- (3) The known and future income tax burdens on the estimated probable future income from said oil properties.
- (4) Every element, physical or otherwise, which will reflect on the income emanating from the operation or production of the oil properties.
- (5) The opinion of qualified and experienced witnesses.
- (6) The stipulated facts and documents and evidence contained in the record.

(M) In determining the fair market value of the oil properties of Dominguez Estate Company to erroneously assume, contrary to the facts set forth in the stipulation and record, that the "computation of the estimated probable future income from the oil properties" was a fixed, certain amount to be received.

(N) When determining the fair market value of the oil properties of Dominguez Estate Company, in giving credence to the opinions expressed by witnesses Grimes and Phillips, who are not oil engineers and who were not familiar with the oil properties and whose value was based in the one case, upon an erroneous formula derived merely from stock market quotations of a date more than five months prior to the date of the gift, and in the other, upon a misapplication of a formula prepared by some one else and without having been informed as to the estimated probable future production in barrels. [670]

(O) When determining the fair market value of the oil properties of Dominguez Estate Company, in accepting the values given by witnesses Grimes and Phillips, whose testimony was substantially repudiated by four other witnesses called by the respondent.

(P) When determining the fair market value of the oil properties of Dominguez Estate Company, in assuming that witness Eitner gave an opinion as to the fair market value of said oil properties.

(Q) When determining the fair market value of the stock of the Dominguez Estate Company, in failing to take into consideration:

- (1) The company's net worth.
- (2) The company's earning power.
- (3) The company's dividend-paying capacity.

(4) The effect upon the value of said stock of income tax burdens.

(5) The relative values, in relation to assets and earnings, of listed stocks as required by section 811(k) of the Internal Revenue Code.

(6) The then depressed economic conditions.

(7) All other relevant factors having a bearing upon the said stock as required by respondent's regulations and established court decisions.

(R) In assuming that the fair market value of the stock of Dominguez Estate Company was a sum equivalent to the value of its net assets divided by the number of its outstanding shares, and in giving credence to the testimony of experts who admitted that their values were obtained by dividing the assets by the number of shares outstanding.

(S) In failing to give proper discount for the fact that [871] petitioner's 200 shares of the stock of Carson Estate Company, the subject of the gift, were a minority interest unable to force a liquidation.

(T) In considering transfers of the stocks in question between members of the families where the stipulated facts showed that such transfers were too far removed from June 5, 1941, to have any relevancy or materiality in a determination of value as of that date, and were not bona fide, arms-length transactions having any relevancy to the question of fair market value.

II.

The Court in Which Review is Sought

The United States Circuit Court of Appeals for the Ninth Circuit is the Court in which review of said decision of The Tax Court of the United States is sought pursuant to the provisions of Section 1141 of the Internal Revenue Code.

III.

Venue

The denials of petitioner's motions for rehearing and reconsideration were entered on August 20, 1946, and the denial of petitioner's motion for review by the full Tax Court of the United States was entered on August 21, 1946. The final decision determining a deficiency was entered on November 12, 1946.

For many years last past petitioner has resided and does now reside in the County of Orange, State of California. She filed her Federal gift tax return for the year 1941 with the United States Collector of Internal Revenue for the Sixth District of California, whose office is located at Los Angeles, California, and within the Ninth Judicial Circuit of the United States. [872]

The parties hereto have not stipulated that said decision may be reviewed by any Court of Appeals other than the one herein designated.

Wherefore, petitioner prays that the denial of

petitioner's motions and the decision of The Tax Court of the United States herein be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that a transcript of the record be prepared in accordance with the law and rules of said Court and transmitted to the Clerk of said Court for filing; and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

Dated November 13th, 1946.

/s/ A. CALDER MACKAY,
/s/ ARTHUR McGREGOR,
/s/ HOWARD W. REYNOLDS,
/s/ ADAM Y. BENNION,
Counsel for Petitioner.

Filed Nov. 18, 1946. [873]

[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION
FOR REVIEW

To John P. Wenchel, Chief Counsel,
Bureau of Internal Revenue,
Washington, D. C.

You are hereby notified that the petitioner on the day of November, 1946, filed with the Clerk of The Tax Court of the United States at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of The Tax Court of the United States heretofore rendered in the above-entitled cause, and of its denial of petitioner's motions for rehearing, reconsidering and review by the full Court. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 18th day of November, 1946.

/s/ A. CALDER MACKAY,
/s/ ARTHUR McGREGOR,
/s/ HOWARD W. REYNOLDS,
/s/ ADAM Y. BENNION,

Counsel for Petitioner. [874]

Personal service of the foregoing notice, together with a copy of the petition for review, is hereby acknowledged this 18th day of November, 1946.

/s/ J. P. WENCHEL, C.A.R.

Bureau of Internal Revenue
Counsel for Respondent.

Filed Nov. 18, 1946. [875]

The Tax Court of the United States
Tax Court Docket

No. 2257

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

MOTION FOR ORDER DIRECTING TRANS-
MISSION OF EXHIBITS IN ORIGINAL
FORM

Whereas, the petitioner above named has heretofore filed a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision entered herein by The Tax Court of the United States; and

Whereas, the petitioner intends to designate for inclusion in the record on review in this cause the following:

Stipulation of facts filed on October 8, 1945, with Joint Exhibits 1-A to 20-T, inclusive, attached thereto;

Stipulation filed on October 19, 1945, with Exhibits 1, 2, and 3 attached thereto;

Petitioner's exhibits 21 to 31, inclusive, filed at the hearing; and

Respondent's exhibits AA to MM-2, inclusive, (except exhibits EE and FF), filed at the hearing;

and

Whereas, the petitioner alleges that, in the interest of economy and for other reasons, the stipulations and exhibits hereinabove referred to should be transmitted to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit in their original form, and that an order of this Honorable Court should be entered to that end in conformity with Rule 75 (i) of the Federal Rules of Civil Procedure; [876]

Now, Therefore, petitioner, by and through her counsel, respectfully moves that an order be entered by this Honorable Court directing that the stipulations and exhibits set forth hereinabove be transmitted to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit in their original form with the record on review in this cause and containing such further orders regarding the safekeeping, transportation and return thereof as shall be deemed proper.

Dated December . . , 1946.

/s/ A. CALDER MACKAY,
/s/ ARTHUR McGREGOR,
/s/ HOWARD W. REYNOLDS,
/s/ ADAM Y. BENNION,

Counsel for Petitioner.

Filed Dec. 5, 1946. [877]

[Title of Tax Court and Cause.]

ORDER RE TRANSMISSION OF DOCUMENTS IN ORIGINAL FORM

Upon consideration of the motion filed by petitioner in the above case for transmission of original documents to the United States Circuit Court of Appeals for the Ninth Circuit, it is

Ordered, that the duplicate original of the stipulation of facts filed October 8, 1945 with joint original exhibits 1-A to 20-T attached thereto; duplicate original of stipulation filed October 19, 1945 with original exhibits 1, 2, and 3 attached thereto; petitioner's exhibits 21 to 31, inclusive and respondent's exhibits AA to MM-2, inclusive (except exhibits EE and FF) be transmitted by the Tax Court of the United States to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit as physical documents in lieu of reproduction of copies in the certified record on review.

/s/ BYRON B. HARLAN,
Judge.

Dated: Washington, D. C., December 9, 1946.

[Title of Tax Court and Cause.]

PETITIONER'S DESIGNATION OF CON-
TENTS OF RECORD ON REVIEW

To the Clerk of The Tax Court of the United States:

The petitioner hereby designates for inclusion in the record on review in the above entitled proceeding the following:

The complete record of all the proceedings and evidence taken before The Tax Court of the United States and all matters required by Subdivision (g) of Rule 75 of the Federal Rules of Civil Procedure, including the following:

1. Docket entries of all proceedings before The Tax Court.
2. Pleadings before The Tax Court,
 - a. Petition, including annexed copy of deficiency letter.
 - b. Answer.
3. The Memorandum Findings of Fact and Opinion of The Tax Court.
4. Motion for Rehearing and denial thereof.
5. Motion for Reconsideration and denial thereof.
6. Motion for Review by Full Court.
7. Order dated August 21, 1946, denying Motion for Review by Full Court.

8. The decision of The Tax Court. [879]
9. The official transcript of oral testimony, pages 1 to 765, inclusive.
10. Stipulation of consolidation, etc., filed on October 8, 1945.
11. Stipulation of Facts filed on October 8, 1945, with Joint Exhibits 1-A to 20-T, inclusive, attached thereto.
12. Stipulation filed on October 19, 1945, with Exhibits 1, 2 and 3 attached thereto.
13. Petitioner's Exhibits 21 to 31, inclusive, filed at the hearing.
14. Respondent's Exhibits AA to MM-2, inclusive (except Exhibits EE and FF), filed at the hearing.
15. The Petition for Review by the United States Circuit Court of Appeals for the Ninth Circuit.
16. Notice of Filing of Petition for Review, together with proof of service thereof and of service of a copy of the Petition for Review.
17. Motion and order directing the transmission in their original form of items 11 to 14 above, inclusive.
18. This designation of contents of record on review.

Dated December . . , 1946.

/s/ A. CALDER MACKAY,
/s/ ARTHUR McGREGOR,
/s/ HOWARD W. REYNOLDS,
/s/ ADAM Y. BENNION,

Counsel for Petitioner. [880]

ACKNOWLEDGEMENT OF SERVICE

Personal service of a copy of the foregoing designation is hereby acknowledged as having been made this 5th day of December, 1946.

/s/ J. P. WENCHEL, SLV
Chief Counsel, Bureau of In-
ternal Revenue, Counsel for
Respondent.

Filed Dec. 5, 1946. [881]

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 881, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand

and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 13th day of December, 1946.

[Seal] /s/ VISTOR S. MERCH, EMT
Clerk.

[Endorsed]: No. 11506. United States Circuit Court of Appeals for the Ninth Circuit. Victoria L. Cotton, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed December 19, 1946.

 /s/ PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

No. 11506

United States
Circuit Court of Appeals
For the Ninth Circuit.

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

Book of Exhibits

In Three Volumes

VOLUME III

Pages 787 to 976

Upon Petitions to Review a Decision of the Tax Court
of the United States

FILED
MAR 27 1947

No. 11506

United States
Circuit Court of Appeals
For the Ninth Circuit.

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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Upon Petitions to Review a Decision of the Tax Court
of the United States

The Tax Court of The United States

Docket No. 2257

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 7583

VIRGINIA CALDWELL,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

STIPULATION

It is hereby stipulated by and between the parties hereto, through their respective counsel, that the following facts are true:

(1) That on June 10, 1936, pursuant to an agreement dated May 8, 1936, copy of which is attached hereto and marked Exhibit 1, Reyes-Dominguez Company purchased from Title Insurance and Trust Company, as Executor of the Estate of Maria De Los Reyes D. de Francis, 365 shares of the capital stock of Francis Land Company, for which Reyes-Dominguez Company paid the sum of \$365,000.00.

(2) That on October 1, 1936, Joseph N. Carson sold to Louisa P. Watson 3 shares of the capital stock of Francis Land Company and received therefor the sum of \$3,300.00.

(3) That on October 6, 1936, Lucile W. Martin made a gift of five shares of the capital stock of Francis Land Company to her husband, William S. Martin, and in her gift tax return reported as the then value of said five shares the sum of \$5,500.00; that on the books of account of Lucile W. Martin the said five shares of stock of Francis Land Company were reflected at an income tax cost basis of \$1,100.00 per share.

(4) That on January 18, 1939, Victoria L. Cotton, petitioner herein, sold to her daughter, Victoria C. Ogden, 16 shares of the capital stock of Francis Land Company and as consideration therefor received a non-interest bearing note in the sum of \$16,000.00.

(5) That on January 18, 1939, Victoria L. Cotton, petitioner herein, sold to her daughter, Lucy Cotton, 17 shares of the capital stock of Francis Land Company and as consideration therefor received a non-interest bearing note in the sum of \$17,000.00.

(6) That on or about September 15, 1939, Title Insurance and Trust Company, as Trustee under its Trust No. E-9830.4 (created under the will of Maria De Los Reyes D. de Francis) made a complete distribution of its then assets; that Lucy Rasmussen

was then entitled to receive 72.03267 shares of the capital stock of Francis Land Company; that inasmuch as Francis Land Company could not issue fractional shares an adjustment was made and as a result thereof 72 shares of the capital stock of Francis Land Company were distributed to Lucy Rasmussen and at the same time there was distributed to her \$32.67 in cash in full settlement of her interest in the fractional shares.

(7) That on April 24, 1941, Lucy Rasmussen sold to her son, Neil Rasmussen, Jr., 35 shares of the capital stock of Francis Land Company and received as consideration therefor a non-interest bearing note in the sum of \$38,281.28; that the income tax cost basis to Lucy Rasmussen of the stock of Francis Land Company as reflected on her books was \$1,093.75 per share.

(8) That on April 24, 1941, Lucy Rasmussen sold to her son, Arthur H. Rasmussen, 35 shares of the capital stock of Francis Land Company and received as consideration therefor a non-interest bearing note in the sum of \$38,281.28; that the income tax cost basis to Lucy Rasmussen of the stock of Francis Land Company as reflected on her books was \$1,093.75 per share.

(9) That on April 24, 1941, Lucy Rasmussen sold to her son, George C. C. Rasmussen, 35 shares of the capital stock of Francis Land Company and received as consideration therefor a non-interest bearing note in the sum of \$38,281.28; that the income tax cost basis to Lucy Rasmussen of the stock

of Francis Land Company as reflected on her books was \$1,093.75 per share.

(10) That on or about June 12, 1936, John F. Watson, pursuant to a property settlement agreement with his estranged wife, Helen R. Watson, copy of which agreement is attached hereto and marked Exhibit 2, transferred to said Helen R. Watson 50 shares of stock of Dominguez Estate Company; that the income tax cost basis to John F. Watson of said shares of stock of Dominguez Estate Company as reflected on his books was \$1,000.00 per share.

(11) That on or about June 10, 1936, pursuant to the agreement dated May 8, 1936 (Exhibit 1), Reyes-Dominguez Company purchased from the O'Melvenys (designated in said agreement) 1100 shares of the capital stock of Dominguez Estate Company, for which it paid the sum of \$1,100,000.00.

(12) That on or about October 2, 1936, Joseph N. Carson sold a total of 11 shares of the capital stock of Dominguez Estate Company to the following named individuals and received therefor the total sum of \$11,000.00:

Name	No. Shares
Virginia Caldwell	1
Jarrett Estate Company	1
David V. Carson	1
Robert L. Watson	3
E. H. Carson	1
Louisa P. Watson	3
Susana Watson Lacayo	1

that the income tax cost basis to Joseph N. Carson of the stock of Dominguez Estate Company as reflected on his books was \$1,000.00 per share.

(13) That on October 5, 1936, Lucile W. Martin transferred by way of gift to William S. Martin 15 shares of the capital stock of Dominguez Estate Company, and in her gift tax return reported the value of the gift to be \$15,000.00; that the books of account of Lucile W. Martin reflected an income tax cost basis to her of the stock of Dominguez Estate Company of \$1,000.00 per share.

(14) That on January 18, 1939, Victoria L. Cotton, petitioner herein, sold to her daughter, Victoria C. Ogden, 50 shares of the capital stock of Dominguez Estate Company and as consideration therefor received a non-interest bearing note in the sum of \$50,000.00.

(15) That on January 18, 1939, Victoria L. Cotton, petitioner herein, sold to her daughter, Lucy Cotton, 49 shares of the capital stock of Dominguez Estate Company and as consideration therefor received a non-interest bearing note in the sum of \$49,000.00.

(16) That on April 24, 1941, Lucy Rasmussen sold to her son, Neil Rasmussen, Jr., 33 shares of the capital stock of Dominguez Estate Company and received as consideration therefor a non-interest bearing note in the sum of \$33,000.00; that the income tax cost basis to Lucy Rasmussen of the stock of Dominguez Estate Company as reflected on her books was \$1,000.00 per share.

(17) That on April 24, 1941, Lucy Rasmussen sold to her son, Arthur H. Rasmussen, 33 shares of the capital stock of Dominguez Estate Company and received as consideration therefor a non-interest bearing note in sum of \$33,000.00; that the income tax cost basis to Lucy Rasmussen of the stock of Dominguez Estate Company as reflected on her books was \$1,000.00 per share.

(18) That on April 24, 1941, Lucy Rasmussen sold to her son, George C. C. Rasmussen, 33 shares of the capital stock of Dominguez Estate Company and received as consideration therefor a non-interest bearing note in the sum of \$33,000.00; that the income tax cost to Lucy Rasmussen of the stock of Dominguez Estate Company as reflected on her books was \$1,000.00 per share.

(19) That J. R. Lacayo, pursuant to an agreement dated October 3, 1940, by and between Louisa Watson and Susana Watson Lacayo, as Executrices of the Last Will and Testament of Robert Lee Watson, Deceased, and said J. R. Lacayo, copy of which is attached hereto and marked Exhibit 3, received two and two-thirds shares of the capital stock of the Francis Land Company.

(20) That on October 13, 1936, Robert L. Watson transferred by gift two shares of the capital stock of Dominguez Estate Company to his wife, Louisa P. Watson, and one share of the capital stock of Dominguez Estate Company to his daughter, Susana Watson Lacayo, and did not report the

same in a gift tax return for the reason that the value did not exceed the annual exclusion.

(21) That on April 18, 1940, John F. Watson sold to his brother, Alphonse L. Watson, two shares of the capital stock of Dominguez Estate Company for the sum of \$1,400.00.

(22) That on February 26, 1937, Victoria L. Cotton made a gift of 16 shares of the capital stock of the Carson Estate Company to her daughter, Victoria C. Ogden, and also a gift of 16 shares of the capital stock of the Carson Estate Company to her daughter, Lucy Cotton, neither of which gifts was reported in a gift tax return as she considered that they did not exceed the annual exclusion.

(23) That on December 20, 1938, Lucy Rasmussen gave to each of her sons, Neil Rasmussen, Jr., Arthur H. Rasmussen, and George C. C. Rasmussen, respectively, 10 shares of the capital stock of Carson Estate Company, which gifts were not reported in a gift tax return because she believed they did not exceed the annual exclusion.

(24) That on December 23, 1940, Lucy Rasmussen gave to each of her sons, Neil Rasmussen, Jr., Arthur H. Rasmussen and George C. C. Rasmussen, respectively, eight shares of the capital stock of Carson Estate Company, which gifts were not reported in a gift tax return under the belief that they did not exceed the annual exclusion.

(25) That on September 18, 1939, Lucile W. Martin made a gift to her son, William S. Martin,

Jr., of two shares of the capital stock of Francis Land Company, and did not report the same in a gift tax return because she believed the gift did not exceed the annual exclusion.

(26) That on or about September 15, 1939, Title Insurance and Trust Company, as Trustee under its Trust No. E-9830.4 (created under the will of Maria De Los Reyes D. de Francis) made a complete distribution of its then assets; that Edward A. Carson was then entitled to receive 72.03267 shares of the capital stock of Francis Land Company; that inasmuch as Francis Land Company could not issue fractional shares an adjustment was made and as a result thereof 72 shares of the capital stock of Francis Land Company were distributed to Edward A. Carson and at the same time there was given to him \$32.67 in cash in full settlement of his interest in the fractional share.

(27) That on or about September 15, 1939, Title Insurance and Trust Company, as Trustee under its Trust No. E-9830.4 (created under the will of Maria De Los Reyes D. de Francis), made a complete distribution of its then assets; that John F. Watson was then entitled to receive 7.47005 shares of the capital stock of Francis Land Company; that inasmuch as Francis Land Company could not issue fractional shares an adjustment was made and as a result thereof seven shares of the capital stock of Francis Land Company were distributed to John F. Watson and at the same time there was given to him \$470.05 in cash in full settlement of his interest in the fractional share.

(28) That on August 8, 1935, the Carson Estate Company purchased six shares of stock of Carson Estate Company from Hunsaker & Cosgrove, for which it paid the sum of \$1,800.00.

(29) That on September 10, 1936, John F. Watson transferred to his sister, Lavena Watson Brown, six shares of the capital stock of Dominguez Estate Company for a beach house which had cost approximately \$6,000.00.

(30) That on or about June 26, 1936, the Estate of George H. Carson, Deceased, sold, and Carson Estate Company purchased, 82 shares of the capital stock of Carson Estate Company for the sum of \$24,600.00.

(31) That Reyes-Dominguez Company about October, 1936, distributed in liquidation, among other things, 1100 shares of the capital stock of Dominguez Estate Company and 370 shares of the capital stock of Francis Land Company; that inasmuch as the by-laws of each of these companies prohibited the issuance of fractional shares, an adjustment was made with respect to the fractional shares and these adjustments were made with respect to Dominguez Estate Company stock on the basis of \$1,000.00 per share and with respect to Francis Land Company stock on the basis of \$1,100.00 per share.

It Is Further Stipulated and Agreed that counsel

for petitioners may object to the relevancy or materiality of the foregoing statement of facts.

/s/ A. CALDER MACKAY,
/s/ ARTHUR McGREGOR,
/s/ HOWARD W. REYNOLDS,
/s/ ADAM Y. BENNION,
Counsel for Petitioner.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

Filed T.C.U.S. Oct. 19, 1945.

[Endorsed]: Filed U.S.C.C.A. Dec. 20, 1946.

The Tax Court of The United States

Docket No. 2257

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

Respondent.

STIPULATION OF FACTS

It is hereby mutually stipulated and agreed, by and between the parties hereto, through their respective counsel of record, that, in addition to the

facts established by the pleadings and for the purposes of the above-entitled proceeding, the following facts and joint exhibits, which are attached hereto and made a part hereof, shall be taken to be true and received as evidence herein, without prejudice to the right of either party to introduce other and further evidence not inconsistent therewith:

(1) That the "Book Values" and "Stipulated Fair Market Values" of assets and liabilities as at May 31, 1941, stipulated in Joint Exhibits 1-A, 2-B, and 3-C are the book values and agreed fair market values as at June 5, 1941.

(2) That stock holdings as at May 31, 1941, as disclosed by Joint Exhibits 13-M, 14-N, and 15-O are identical with the stock holdings as at June 5, 1941, prior to the gift transfers of stock by the petitioner on June 5, 1941, which are the gifts involved in this proceeding.

(3) That, subject to verification of such data by opposing counsel, expert witnesses may refer to data published in authoritative financial manuals and journals without producing such manuals and journals in Court. That the manuals and journals regarded as authoritative shall include, but are not limited to, Moody's Manual, Poor's Manual, Standard Statistics Company's publications, Commercial and Financial Chronicle and its Supplements, Wall Street Journal, and National Quotation Bureau's publications.

(4) That attached hereto, and made a part here-

of, are Joint Exhibits 1-A to 20-T, inclusive, described as follows:

(a) Joint Exhibit 1-A is a condensed balance sheet for Dominguez Estate Company as at May 31, 1941, with descriptions of assets and liabilities, book values for assets and liabilities and stipulated fair market values for certain assets and for certain liabilities. The parties hereto have not agreed upon the fair market values of certain assets and liabilities which items are marked "at issue" in the column headed "Stipulated Fair Market Values".

(b) Joint Exhibit 2-B is a condensed balance sheet for Francis Land Company as at May 31, 1941, with descriptions of assets and liabilities, book values for assets and liabilities and stipulated fair market values for certain assets and for certain liabilities. The parties hereto have not agreed upon the fair market values of certain assets and liabilities which items are marked "at issue" in the column headed "Stipulated Fair Market Values."

(c) Joint Exhibit 3-C is a condensed balance sheet for Carson Estate Company as at May 31, 1941, with descriptions of assets and liabilities, book values for assets and liabilities and stipulated fair market values for certain assets and for certain liabilities. The parties hereto have not agreed upon the fair market values of certain assets and liabilities which items are marked "at issue" in the column headed "Stipulated Fair Market Values."

(d) Joint Exhibit 4-D is a true and correct statement for Dominguez Estate Company of its

profit and loss accounts, surplus adjustments, dividends and earned surplus balances, per books, for the calendar years 1927 to 1940, inclusive, and for the five-month period January 1 to May 31, 1941. For the purposes of this proceeding the income shown on said exhibit, except for the five months in 1941, may be taken as the correct income before percentage depletion except for cost depletion shown on said exhibit.

With respect to the income for the five-month period in 1941, either party may assume that the income shown on said exhibit for said period may be correct, or may assume that 5/12ths of the income shown on Joint Exhibit 4-D(1) may be correct.

Royalty income in said exhibit does not include royalties from the Reyes, De Frances, and Manuel leases prior to acquisition in October, 1928.

(e) Joint Exhibit 5-E is a true and correct statement for Francis Land Company of its profit and loss accounts, surplus adjustments, dividends and earned surplus balances, per books, for the calendar years 1927 to 1940, inclusive, and for the five-month period January 1 to May 31, 1941. For the purposes of this proceeding the income shown on said exhibit, except for the five months in 1941, may be taken as the correct income before percentage depletion except for cost depletion shown on said exhibit.

With respect to the income for the five-month period in 1941, either party may assume that the

income shown on said exhibit for said period may be correct, or may assume that 5/12ths of the income shown on Joint Exhibit 5-E(1) may be correct.

(f) Joint Exhibit 6-F is a true and correct statement for Carson Estate Company of its profit and loss accounts, surplus adjustments, dividends and earned surplus balances, per books, for the calendar years 1927 to 1940, inclusive, and for the five-month period January 1 to May 31, 1941. For the purposes of this proceeding the income shown on said exhibit, except for the five months in 1941, may be taken as the correct income before percentage depletion except for cost depletion shown on said exhibit.

With respect to the income for the five-month period in 1941, either party may assume that the income shown on said exhibit for said period may be correct, or may assume that 5/12ths of the income shown on Joint Exhibit 6-F(1) may be correct.

(g) Joint Exhibit 7-G is an approximate but substantially correct allocation to specific phases of the business of Dominguez Estate Company of parts of the item entitled "general and administrative" appearing under deductions in Joint Exhibit 4-D.

(h) Joint Exhibit 8-H is an approximate but substantially correct allocation to specific phases of the business of Carson Estate Company of parts of the item entitled "general and administrative" appearing under deductions in Joint Exhibit 6-F.

(i) Joint Exhibit 9-I is an approximate but substantially correct allocation to specific phases of the business of Dominguez Estate Company of parts of the item entitled "surplus adjustments" appearing under deductions in Joint Exhibit 4-D.

(j) Joint Exhibit 10-J is an approximate but substantially correct allocation to specific phases of the business of Carson Estate Company of parts of the item entitled "surplus adjustments" appearing under deductions in Joint Exhibit 6-F.

(k) Joint Exhibit 11-K(1) is the estimated amount, in barrels of oil, of ultimate probable future production from known oil reserves of all oil properties owned by Dominguez Estate Company on June 5, 1941, together with the royalty share of Dominguez Estate Company therein. The estimated probable future production by calendar years is based upon the assumption that all wells being produced on June 5, 1941, would continue to be produced to the full indicated capacity of the formation to yield the oil, and, further, that each probable productive location of said known oil reserves would be developed and produced to its full indicated capacity in accord with its probable development program.

Joint Exhibit 11-K(2) is a computation, based upon said Joint Exhibit 11-K(1) and upon an agreed price per barrel of oil, said price being net revenue per barrel of royalty oil received from January 1 to May 31, 1941. The estimated probable royalty income by calendar years is based upon the

assumption that the production will be in accord with the rates set forth in Joint Exhibit 11-K(1).

It is understood and agreed that nothing contained in said Joint Exhibits 11-K(1) and/or 11-K(2) shall limit either party in presenting evidence with respect to discounts and other factors and/or methods that might be taken into consideration in determining the fair market value of said oil royalties or in presenting evidence of such fair market value based upon other indices.

Royalty income from the Carpenter well, by years from 1941 through 1947, has been reduced by \$150.00 per annum to compensate for rental payments.

(1) Joint Exhibit 12-L(1) is the estimated amount, in barrels of oil, of ultimate probable future production from known oil reserves of all oil properties owned by Carson Estate Company on June 5, 1941, together with the royalty share of Carson Estate Company therein. The estimated probable future production by calendar years is based upon the assumption that all wells being produced on June 5, 1941, would continue to be produced to the full indicated capacity of the formation to yield the oil, and, further, that each probable productive location of said known oil reserves would be developed and produced to its full indicated capacity in accord with its probable development program.

Joint Exhibit 12-L(2) is a computation, based upon said Joint Exhibit 12-L(1) and upon an

agreed price per barrel of oil, said price being net revenue per barrel of royalty oil received from January 1 to May 31, 1941. The estimated probable royalty income by calendar years is based upon the assumption that the production will be in accord with the rates set forth in Joint Exhibit 12-L(1).

It is understood and agreed that nothing contained in said Joint Exhibits 12-L(1) and/or 12-L(2) shall limit either party in presenting evidence with respect to discounts and other factors and/or methods that might be taken into consideration in determining the fair market value of said oil royalties or in presenting evidence of such fair market value based upon other indices.

(m) Joint Exhibit 13-M is a complete list of stock holdings in Dominguez Estate Company as at May 31, 1941.

(n) Joint Exhibit 14-N is a complete list of stock holdings in Francis Land Company as at May 31, 1941.

(o) Joint Exhibit 15-O is a complete list of stock holdings in Carson Estate Company as at May 31, 1941.

(p) Joint Exhibit 16-P is a chart showing inter-corporate stock holdings of Dominguez Estate Company, Francis Land Company, Carson Estate Company, and other related corporations.

(q) Joint Exhibit 17-Q is a map of the Dominguez Oil Field, showing the oil properties of

Dominguez Estate Company colored in red, the oil properties of Carson Estate Company colored in blue, and the joint oil properties of Dominguez Estate Company and Carson Estate Company indicated by red and blue crosshatching. Said map also shows the approximate acreage of each of said oil properties and the surface location of all drill holes on said properties at or about June 5, 1941.

(r) Joint Exhibit 18-R is a map of the Torrance Oil Field, showing the oil properties of Dominguez Estate Company colored in red and the oil properties of Carson Estate Company colored in blue. Said map also shows the approximate acreage of each of said oil properties and the surface location of all drill holes on said properties at or about June 5, 1941.

(s) Joint Exhibit 19-S is a map of the Wilmington Oil Field, showing the oil property of Dominguez Estate Company colored in red. Said map also shows the approximate acreage of said property and the surface location of all drill holes on said property at or about June 5, 1941.

(t) Joint Exhibit 20-T is a map of the Hilldon-Caminol-Victory "Dominguez-Carson" leases, showing the joint leases of Dominguez Estate Company and Carson Estate Company by red and blue crosshatching. Said map also shows the approximate acreage of each of said properties and the surface

location of all drill holes on said properties at or about June 5, 1941.

/s/ A. CALDER MACKAY,
/s/ ARTHUR MCGREGOR,
/s/ HOWARD W. REYNOLDS,
/s/ ADAM Y. BENNION,
Counsel for Petitioner.

/s/ J. P. WENCHEL, BHN
Chief Counsel, Bureau of In-
ternal Revenue, Counsel for
Respondent.

Filed T.C.U.S. Oct. 8, 1945.

[Endorsed]: Filed U.S.C.C.A. Feb. 20, 1946.

EXHIBIT No. 1

This Memorandum of an Agreement made as of the 8th day of May, 1936, by and between the following parties:

First: Henry W. O'Melveny, Stuart O'Melveny, John O'Melveny, Donald O'Melveny, Isabel Watson O'Melveny, Phila Miller O'Melveny, as Parties of the First Part, sometimes herein collectively designated as "O'Melvenys";

Second: Edward A. Carson, David V. Carson, Joseph N. Carson, also known as Joseph Carson, Virginia Caldwell, Lucy C. Rasmussen, Amelia Atherton Drudis, Victoria Cotton, Valerie C. Hanrahan, Gladys C. Scheller, John Victor Carson,

Exhibit No. 1—(Continued)

George Earl Carson, also known as G. Earl Carson and as Earl Carson, as Parties of the Second Part, sometimes herein collectively designated as “Carsons”;

Third: Robert L. Watson, Gracia Watson Rollins, Title Insurance and Trust Company, as assignee of and Trustee for Gracia Watson Rollins, Lucile Watson Martin, Anita Watson, Alphonse Watson, John F. Watson, Victoria Limacher, Lavena Watson Brown, Watson Jarrett, Jarrett Estate Company, a Corporation (as successor of Watson Jarrett and Dudley Jarrett), as Parties of the Third Part, sometimes herein collectively designated as “Watsons”;

Fourth: Reyes-Dominguez Company, a Corporation, as Party of the Fourth Part, sometimes herein designated as “Reyes Company”;

Fifth: Title Insurance and Trust Company, individually and as Executor of the Will of Maria De Los Reyes D. de Francis, Deceased, and as Trustee designated by said Will in respect of the trusts declared therein, as Party of the Fifth Part, sometimes herein designated, according to the capacity in which it is referred to, as “Executor” or as “Trustee”;
and

Sixth: H. W. O'Melveny, John O'Melveny, Walter K. Tuller, Louis W. Myers, Paul E. Schwab, Paul Fussell, William W. Clary, James L. Beebe,

Exhibit No. 1—(Continued)

Harry L. Dunn and Pierce Works, co-partners under the firm name and style of O'Melveny, Tuller & Myers, together with all associate attorneys regularly employed by said co-partners, as Parties of the Sixth Part, sometimes herein designated as "Law Firm":

Witnesseth:

That, Whereas, the Carsons and the Watsons are all of the heirs at law of Maria De Los Reyes D. de Francis, deceased, and are also beneficiaries under her Last Will and Testament, including the Codicil thereto (except that Jarrett Estate Company is the successor of Dudley Jarrett and Watson Jarrett in such capacity, and Title Insurance and Trust Company is the Assignee of and Trustee for Gracia Watson Rollins in such capacity) heretofore admitted to probate in and by the Superior Court of the State of California in and for the County of Los Angeles, in the proceedings now pending therein for the administration of said decedent's estate, bearing her name and designated as Probate Case No. 136707 of the records of said Court, wherein said Executor was appointed and qualified in such capacity, and has ever since been and now is the fully appointed, qualified and acting Executor of said Will, and in said proceedings said Executor has employed, and until lately has had the Law Firm as its counsel therein; and

Exhibit No. 1—(Continued)

Whereas, the Carsons, or some of them, have now and heretofore asserted that said decedent to and at the time of her death had, and was rightfully entitled to assert and enforce, certain claims, demands and rights against the O'Melvenys (or as to the several items thereof, against some one or more of them) on account of and arising and resulting from certain gifts, or purported gifts, claimed to have been made by said Maria De Los Reyes D. de Francis in her lifetime to said O'Melvenys, or some of them, and from certain acts and transactions of said H. W. O'Melveny while acting in the capacity of her representative and attorney in fact (including the right to set aside said gifts or purported gifts); and that such claims, demands and rights have accrued to and constitute part of her estate, and are enforceable and should be enforced by her Executor on behalf of said estate and the persons interested therein, all of which claims have been respectively controverted and denied by the O'Melvenys, and each of them; and

Whereas, the O'Melvenys, the Executor, the Carsons and the Watsons, are willing, finally and forever, to settle and compromise all of said claims and demands in the manner and on the basis hereinafter provided; and

Whereas, the O'Melvenys represent that they are respectively the owners and holders of record of the shares of the capital stock of Dominguez Estate Company, a California corporation, evidenced by

Exhibit No. 1—(Continued)

the certificates therefor issued to them as hereinafter set forth, which shares they desire to sell to Reyes Company and which Reyes Company desires to purchase from them at the price and upon the basis hereinafter provided; and all of the shares of Reyes Company are included in said decedent's estate and are bequeathed by said Will to the Carsons and the Watsons (except that certain of said shares are thereby bequeathed to Title Insurance and Trust Company in trust for the benefit of said Joseph Carson, as in said Will provided) and they (said Carsons and Watsons), and said Title Insurance and Trust Company, as Trustee as last aforesaid, approve such purchase by Reyes Company; and

Whereas, by said Will, and by the paragraph thereof designated "Twentieth", all of the residue of said estate not otherwise specifically disposed of is given, devised and bequeathed unto said Trustee, upon the trusts therein provided, for the benefit of those of the Carsons and the Watsons therein designated; and

Whereas, the parties hereto believe that the consummation of this compromise agreement will not increase either the Federal Estate Tax chargeable against said estate, or the California Inheritance Tax chargeable against any of the respective interests therein, or create any other State or Federal tax liability, but, nevertheless, the Executor has requested the indemnity and assurance as herein-

Exhibit No. 1—(Continued)

after provided, to the end that said estate may, and upon condition that it shall, be promptly settled and distributed as herein provided, without regard to or delay because of any possibility of such additional tax liability; and

Whereas, the Carsons and the Watsons, or some of them, are stockholders or beneficially interested in Francis Land Company, a California corporation, and also in said Dominguez Estate Company;

Now, therefore, pursuant to the premises, and for the purposes and to the ends aforesaid, it is agreed by and between the parties hereto as follows, to-wit:

1. In and by way of compromise and settlement of the claims and demands asserted against them as aforesaid, the O'Melvenys, jointly and severally, undertake, promise and agree to, and that they will, prior to, or concurrently with payment to them of the purchase price for the eleven hundred (1100) shares of the capital stock of Dominguez Estate Company to be sold by them as hereinafter in the paragraph hereof designated 2 provided (it being contemplated, and the O'Melvenys agree, that to the extent they shall not theretofore have paid the amounts to be paid by them as next hereinafter provided, they will apply thereto so much as may be necessary therefor of said purchase price of said eleven hundred (1100) shares of the capital stock of Dominguez Estate Company):

(a) Fully pay and discharge (and obtain and

Exhibit No. 1—(Continued)

furnish to said Executor, in form satisfactory to it, full and complete acquittances and releases from the legatees thereunder in respect of) each and all of the cash bequests to charity and for charitable or benevolent purposes given and made by said Will, and particularly by the paragraphs thereof designated "Eighth," "Ninth," "Tenth," "Eleventh," and "Fourteenth" (without regard to the validity thereof and irrespective of whether the condition of said estate be such as that said charitable bequests would otherwise have been payable or fully payable) such charitable bequests including all thereof, viz.:

To Right Reverend John J. Cantwell, Bishop of Los Angeles and San Diego, the sum of Three Hundred Thousand Dollars (\$300,000.00);

To Los Angeles Orphan Asylum the sum of Twenty Thousand Dollars (\$20,000.00);

To Sister Marianne of St. Vincent's Hospital the sum of Five Thousand Dollars (\$5,000.00), said legacy having been assigned to said Dominguez Estate Company to which it shall be paid as hereinafter provided;

To Elizabeth Day Nursery the sum of Three Thousand Dollars (\$3,000.00);

To Title Insurance and Trust Company the sum of Sixty Thousand Dollars (\$60,000.00)

Exhibit No. 1—(Continued)

for the care, upkeep and maintenance of the old homestead of the Dominguez family;

including as part of the legacies so assumed and to be paid by the O'Melvenys, any interest or other charges accrued, or which may accrue, thereon; provided that if the O'Melvenys shall be able to settle and discharge any of said legacies by payment of lesser amounts, the benefit of any such saving or discount shall accrue to them; it being contemplated and agreed, however, that they shall, at all events, at or before the time aforesaid and at their own sole cost and expense, discharge said legacies by such payment as shall be necessary therefor, and in such manner as fully to relieve said estate and said Executor therefrom; and provided, further, that if any payment or advancement on account of any of said charitable bequests shall have been or shall be hereafter made, either by said Executor or by any other person or corporation, or if any assignment, or partial assignment, or any such bequest shall have been or shall be made to said Executor or any other person, then, and in either such case, the person or corporation making such advancement or payment, or receiving such assignment, shall, to such extent, be entitled hereunder to payment of the legacy affected.

(b) Transfer, assign, set over and deliver to said Executor in such capacity, and as part of the assets of said estate, and free and clear of any claim, lien, charge or encumbrance whatsoever,

Exhibit No. 1—(Continued)

eleven hundred (1100) shares of the capital stock of Francis Land Company, a California Corporation, which they represent are now evidenced by Certificates as follows:

No. 8 for two hundred (200) shares, issued November 7, 1928, to H. W. O'Melveny;

No. 11 for three hundred (300) shares, issued November 7, 1928, to John O'Melveny;

No. 16 for two hundred (200) shares, issued June 3, 1932, to Isabel O'Melveny;

No. 17 for one hundred (100) shares, issued June 3, 1932, to Stuart O'Melveny;

No. 21 for twenty-five (25) shares, issued December 30, 1935, to Phila Miller O'Melveny;

No. 22 for two hundred seventy-five (275) shares, issued December 30, 1935, to Donald O'Melveny;

and upon and in evidence of such transfer, said O'Melvenys shall deliver to said Executor the Certificates aforesaid, each thereof duly endorsed to it, and with the necessary United States Internal Revenue Stamps upon said transfer affixed thereto, all thereof in such manner and form as to entitle said Executor to have said shares transferred to its name as Executor upon the books of said Francis Land Company.

2. At the time and in the manner hereinafter provided, the O'Melvenys, jointly and severally,

Exhibit No. 1—(Continued)

agree to sell to Reyes Company, and it agrees to buy from them (the Carsons and the Watsons, and Title Insurance and Trust Company as Trustee for Joseph Carson, expressly assenting to said purchase), all thereof, free and clear of any claim, lien, charge, or encumbrance whatsoever, and at and for the price of One Million One Hundred Thousand Dollars (\$1,100,000) cash, eleven hundred (1100) shares of the capital stock of Dominguez Estate Company, a California Corporation, which the O'Melvenys represent are evidenced by certificates as follows:

No. 2-NS for two hundred (200) shares, issued October 10, 1928, to H. W. O'Melveny;

No. 7-NS for three hundred (300) shares, issued October 10, 1928, to John O'Melveny;

No. 60-NS for two hundred (200) shares, issued June 3, 1932, to Isabel O'Melveny;

No. 61-NS for one hundred (100) shares, issued June 3, 1932, to Stuart O'Melveny;

No. 90-NS for twenty-five (25) shares, issued December 30, 1935, to Phila Miller O'Melveny;

No. 91-NS for two hundred seventy-five (275) shares, issued December 30, 1935, to Donald O'Melveny.

Following, and within five days after said Superior Court in said probate proceedings shall have approved this Agreement as to said estate and shall

Exhibit No. 1—(Continued)

have authorized such action on the part of said Executor as shall be necessary to consummation hereof, said O'Melvenys shall and they agree that they will, upon and in evidence and by way of consummation of said sale, transfer and deliver to Reyes Company the certificates aforesaid for said eleven hundred (1100) shares of the capital stock of Dominguez Estate Company, duly endorsed by them to Reyes Company, with the necessary United States Revenue stamps upon such transfer affixed thereto (all thereof in such manner and form as to entitle Reyes Company to have said shares regularly transferred to it upon the books of Dominguez Estate Company), and said purchase price shall thereupon be payable, such delivery and payment being conditions concurrent; provided, and it shall be a condition to such payment and to the O'Melvenys' right thereto, that prior to, or concurrently therewith, they shall comply with all of the obligations devolving upon them under the provisions of the paragraph hereof designated 1; provided, further, that Reyes Company shall have the right, at its election and without formal notice, to defer and postpone such payment for said shares from time to time, but not later than sixty (60) days after written notice to it by the O'Melvenys of the making of such order by said Court, and of the deposit of said certificates of Dominguez Estate Company in escrow, as hereinafter provided, for, and in condition for delivery to, Reyes Company in accordance herewith, and to the effect that the O'Melvenys have

Exhibit No. 1—(Continued)

complied, or are prepared to comply, with the obligations devolving upon them under paragraph hereof designated 1. If such payment shall be so deferred for more than thirty (30) days after such written notice, then said purchase price shall bear interest from and after, but not before, the expiration of such thirty (30) day period until payment of said price, at the rate of three per cent (3%) per annum, which interest shall be payable with the principal. Except in such case and to such extent said purchase price shall not bear interest.

The Trustee, subject to the approval of the Court, and those of the Carsons and the Watsons named in paragraph designated "Sixth" of said will; and Edward A. Carson, David Carson, Virginia Caldwell, Amelia Atherton Drudia, Victoria L. Cotton, Lucile Rasmussen, Joseph Carson, John Victor Carson, George Earl Carson, Gladys Carson Scheller, and Valeria Carson Hanrahan (as successors to George Carson, deceased, under and by virtue of said Codicil to said Will) hereby direct the Executor to joint in and approve said sale and transfer, to the extent of any interest, or apparent interest, of said estate in said shares.

3. By and upon the said transfer to said Executor of said eleven hundred (1100) shares of the capital stock of Francis Land Company, and by and upon the said sale and transfer to Reyes Company of said eleven hundred (1100) shares of the capital stock of Dominguez Estate Company, all thereof,

Exhibit No. 1—(Continued)

as hereinbefore provided, said H. W. O'Melveny as to all of said shares, said Stuart O'Melveny as to those of said shares evidenced by certificates now standing in the names of himself and said Isabel O'Melveny, said Donald O'Melveny as to those of said shares evidenced by certificates now standing in the names of himself and said Phila Miller O'Melveny, and said John O'Melveny as to those of said shares evidenced by certificates now standing in his name, all thereof as aforesaid, shall be further deemed to, and they do hereby respectively and to the extent aforesaid, represent to, and covenant and agree with, said Executor, said estate, and the persons interested therein, as to said shares of Francis Land Company; and to and with said Reyes Company as to said shares of Dominguez Estate Company, as follows: That all of said shares were originally validly issued by Francis Land Company and by Dominguez Estate Company, respectively, unto said Maria De Los Reyes D. De Francis (except as to one hundred (100) of said shares of Dominguez Estate Company, which they likewise represent, covenant and agree were originally validly issued to other persons or corporations); that said shares were thereafter, by mesne transfers, duly and regularly made, transferred to and acquired by said present holders thereof, and that they are now the owners thereof and entitled to make such further transfer; that neither said Maria De Los Reyes D. De Francis (nor the persons or corporations to whom were issued as aforesaid said one hundred

Exhibit No. 1—(Continued)

(100) shares of the capital stock of Dominguez Estate Company), nor said O'Melvenys, nor said intermediate transferees of said shares, nor any of them, have in any manner subjected, or suffered or permitted said shares, or any thereof, to be subjected, to any lien, charge or encumbrance whatsoever, on in any manner done or suffered anything to be done, or omitted anything, which would or might in any way affect or impair title to said shares, or the rights of the holders thereof, so to be transferred to said Executor and to Reyes Company, respectively; and they, the said H. W. O'Melveny as to all of said shares, and said Stuart O'Melveny as to those of said shares so now represented by certificates issued to him and said Isabel O'Melveny, and said Donald O'Melveny as to those of said shares so now represented by certificates issued to him and said Phila Miller O'Melveny, and said John O'Melveny as to those of said shares so now represented by certificates issued to him, expressly covenant and agree to defend such title and said shares against all claims and demands to the contrary, excepting only such taxes, if any, as are hereinafter assumed by Reyes Company, and to which its indemnity in favor of said Executor, as herein-after provided, shall apply (and said O'Melvenys shall not be obligated for or in respect of said taxes, if any). The undertaking and covenants aforesaid upon and in respect of said transfers are additional to and not exclusive of, those provided by Section 330.11 of the Civil Code of the State of California,

Exhibit No. 1—(Continued)

and all thereof, express and implied by said section, shall survive, continue and be enforceable hereunder after such transfers, without merger therein or extinguishment thereby.

4. By and as a feature of the transfer to said Executor of said eleven hundred (1100) shares of the capital stock of Francis Land Company, and by and as a feature of the sale and transfer to said Reyes Company of said eleven hundred (1100) shares of the capital stock of the Dominguez Estate Company, all thereof as hereinbefore provided, said transferees shall respectively be and become entitled to receive and retain, free of any claim and demand whatsoever of the O'Melvenys, or any of them, all dividends of whatsoever kind or character (whether representing distribution of income, capital or surplus, and regardless of when earned) which may have been or may be paid upon any of such shares on or after April 20, 1936 (and the O'Melvenys agree promptly to account for any pay over any thereof received by them), except the following, which shall be paid to the O'Melvenys, viz.:

(a) Thirteen Thousand Two Hundred Dollars (\$13,200.00) out of the next subsequent dividend or dividends declared upon the portion unsold by said Executor as hereinafter provided, of said eleven hundred (1100) shares of the capital stock of the Francis Land Company);

Exhibit No. 1—(Continued)

(b) Thirteen Thousand Two Hundred Dollars (\$13,200.00) out of the next subsequent dividend or dividends declared upon said eleven hundred (1100) shares of the capital stock of the Dominguez Estate Company.

5. In consideration of the agreements of release, and the release by the O'Melvenys, and each of them, and by the Law Firm, and each of its members and employees, in this paragraph contained, and of the performance of the obligations of the O'Melvenys, and each of them, under paragraphs hereof designated "1(a)" and "1(b)", the Executor, subject to the confirmation of the Court, the Reyes Company, and the Carsons and the Watsons, and each of them (individually, as heirs and legatees and/or transferees of Maria De Los Reyes D. De Francis, as heirs of Guadalupe Dominguez, deceased, as stockholders of the Dominguez Estate Company, Francis Land Company and Reyes Company, and in any and all other capacities, whether like or unlike the foregoing) agree, concurrently with the performance by the O'Melvenys of all of the obligations devolving upon them under the paragraphs of this agreement designated 1 and 2, to release and forever discharge, and, subject to such performance by the O'Melvenys, by these presents do release and forever discharge, the O'Melvenys, and each of them, and the Law Firm, from any demands, claims, actions, causes of action, and/or suits at law or in equity, that they, the Executor, the Reyes Company, the Carsons and the Watsons,

Exhibit No. 1—(Continued)

or any of them, may now have or assert, arising out of any acts or omissions which have heretofore been done or suffered by the O'Melvenys, or any of them, or the Law Firm, of any and every nature whatsoever, including (without limiting the generality of the foregoing) any and all acts or omissions in connection, directly or indirectly, with the property, business or affairs, of any nature of said Maria De Los Reyes D. De Francis, during her lifetime or after her death, or any acts or omissions which have heretofore been done or suffered in connection with the conduct of her estate, or any acts or omissions which have been done or suffered by the O'Melvenys, or any of them, or the Law Firm, as officers, directors, attorneys, agents or employees of Dominguez Estate Company, Francis Land Company, Reyes Company, Dominguez Wilshire Company, Dominguez Water Company, or in any capacity or capacities whatsoever, whether like or unlike the foregoing, from the beginning of the world to date; and the O'Melvenys, and each of them, and the Law Firm, and each of its members and employees, agree, and by these presents do (upon the said releases by the Executor, the Reyes Company, the Carsons, and the Watsons becoming operative, as aforesaid) forever release and discharge the Executor, the Trustee, the Carson and the Watsons, and each of them, the Reyes Company, the Dominguez Estate Company, the Francis Land Company, the Dominguez Wilshire Company and the Dominguez Water Company, and each and all of them, from any demands,

Exhibit No. 1—(Continued)

claims, actions, causes of actions, and/or suits at law or in equity, of any and every nature whatsoever, that they, the O'Melvenys, or any of them, or the Law Firm, or any of its members or employees, have or may have had from the beginning of the world to date. As a part of the consideration for said releases by the Executor, the Reyes Company, and the Carsons and the Watsons, the Law Firm and the O'Melvenys covenant and agree upon said releases becoming operative as aforesaid, to deliver to Title Insurance and Trust Company as depositary all of their respective files and records relating or pertaining to the business of the said Maria De Los Reyes D. De Francis, her estate, Reyes Company, the Dominguez Estate Company, the Francis Land Company, the Dominguez Water Company, the Dominguez Wilshire Company, and such of the Carsons and Watsons as shall so request in writing, including all correspondence, briefs, memoranda, and working papers, whether or not the same constitute the private property of the persons agreeing to deliver the same. All of said files and records shall be deposited with said Title Insurance and Trust Company with the direction that the parties hereto, and each of them, by their respective representatives and officers, shall have the right to make such examination thereof at all convenient times as they, or any of them, may desire, and that they or any of them may make copies of any portion of said files and records, but with the understanding that none of said files and records

Exhibit No. 1—(Continued)

shall be taken from the possession of said Title Insurance and Trust Company without a proper receipt therefor, and that at the end of five years from the date hereof said files and records may be returned to said O'Melvenys and the Law Firm or to such parties as they may direct. Said Law Firm agrees to request Messrs. Miller, Chevalier, Peeler and Wilson, and Harry Hill, C. P. A., all of Los Angeles, to deliver into said escrow all files and records which they or any of them may have pertaining to the business of said corporations and said estate, to be held in said escrow in like manner as hereinabove set forth; and the O'Melvenys and the Law Firm agree otherwise to co-operate with the other parties hereto to the end that such files and records of Messrs. Miller, Chevalier, Peeler and Wilson and Harry Hill shall be made available for the use and inspection of all of the parties hereto.

6. The Executor shall pay in due course of the administration of said estate all of the legacies and bequests provided in said Will and Codicil other than the charitable bequests to be paid by the O'Melvenys as hereinbefore provided.

Subject to receipt by it of said shares of capital stock of Francis Land Company as hereinabove provided, and to approval by the Court, the Executor agrees to sell to Reyes Company, and it agrees to buy, at the price of One Thousand Dollars (\$1,000.00) per share, such number of said eleven hundred (1100) shares of the stock of Francis Land

Exhibit No. 1—(Continued)

Company as it shall be necessary for said Executor to sell to raise and provide necessary funds for payment of the expenses of the administration of said estate and the legacies under said Will and Codicil in accordance herewith.

7. The Title Insurance and Trust Company agrees within fifteen (15) days from date hereof, subject to the approval of the Court, to sell two hundred seventy (270) shares of the capital stock of Watson Land Company, a California corporation, an asset of said estate, to the Watsons, and the Watsons agree to buy said two hundred seventy (270) shares of capital stock for the price of One Hundred Eight Thousand Six Hundred Eighty-nine Dollars and Twenty-seven Cents (\$108,689.27), payable in cash.

8. Upon and subject to full performance by the O'Melvenys of the obligations devolving upon them under the paragraphs hereof designated "1(a)" and "1(b)", and subject to the closing of the probate administration of decedent's estate and distribution thereof as provided in paragraph 9 hereof, the Carsons and the Watsons severally in the proportion in which they are interested under Paragraphs "Sixth" and "Seventh" of the Will of said decedent, as supplemented by the Codicil thereto, and the Reyes Company, at the request of the Trustee and the Carsons and the Watsons, and each of them (and in consideration of the sale to it of certain shares of the capital stock of Francis Land

Exhibit No. 1—(Continued)

Company as hereinbefore provided) do hereby assume and agree to pay, settle and discharge, and do hereby indemnify and agree to save and hold harmless said Title Insurance and Trust Company, individually, and as such Executor, from and against all liability, or further liability, if any, for Federal Estate Tax, State Inheritance Tax and Gift Tax, arising, or that may arise, or may have arisen, or be asserted, by reason of the death of said decedent, or as a result of any transfers made by her in her lifetime, or on account of the transfer to said Executor of said eleven hundred (1100) shares of the capital stock of Francis Land Company, as herein provided, and from any liability for Federal and State Income Tax upon income received by said Executor as such or in any capacity in which it has represented said decedent prior to her death. The liability of the Carsons and the Watsons under the foregoing provision shall not, as to any one of them, exceed his proportionate part aforesaid of any such tax liability.

To secure performance of the foregoing agreement of indemnity against the tax liability aforesaid, if any, Reyes Company agrees promptly upon approval of this Agreement by the Court as herein provided, to deposit with Title Insurance and Trust Company municipal bonds of the then market value of Three Hundred Fifty Thousand Dollars (\$350,000.00), approved as to value by Frank McGregor of Title Insurance and Trust Company, whereupon

Exhibit No. 1—(Continued)

Reyes Company shall be relieved of all obligation of such indemnity except to the extent of its interest in the securities so deposited which shall remain subject to all of the requirements, obligations and conditions of this indemnity, provided, however, that if the number of shares of Francis Land Company stock unsold by said Executor and available for the residuary trust provided in said Will, shall be less than eight hundred (800), then the amount and value of municipal bonds so to be deposited with Title Insurance and Trust Company shall be increased to the extent of One Thousand Dollars (\$1,000.00) in value for each share of said Francis Land Company stock less than eight hundred (800) so unsold and available for such residuary trust.

Such Executor shall, at or prior to final distribution of said estate, file its final income tax return with the United States Collector of Internal Revenue at Los Angeles, California.

The Security aforesaid shall be exonerated and promptly returned to Reyes Company upon the expiration of three (3) years and sixty (60) days from the filing of said final income tax return, or from the date that the same should have been filed as aforesaid, whichever shall be earlier, unless there shall then be pending and undetermined or unpaid a claim or claims of the United States Government, or of the State of California, for taxes covered by this indemnity, in which event said Title Insurance

Exhibit No. 1—(Continued)

and Trust Company shall be entitled thereafter to retain such security (but only to the extent of a value not exceeding twice the amount of such claim, or claims, plus the interest, penalties and costs reasonably likely to accrue thereon to the time of final determination thereof) until final determination of such claim and payment of any tax which may be found due thereon; provided that if prior to the expiration of said period of three (3) years and sixty (60) days it shall be finally determined that there is no tax liability to which such indemnity applies, or, if any, such tax liability as may be finally determined shall be paid before the expiration of that period, then and in either such case such security shall be exonerated and forthwith returned to Reyes Company.

In the event that any claim is asserted by the United States Government, or by the State of California, against said Title Insurance and Trust Company as Executor or otherwise, for alleged taxes covered by the foregoing indemnity, said Title Insurance and Trust Company shall promptly notify Reyes Company thereof in writing at the address of said Reyes Company last filed with said Title Insurance and Trust Company.

Reyes Company is hereby authorized and empowered, in the name of said Title Insurance and Trust Company, individually and as Executor, or otherwise, to resist any such claim by court action or otherwise as it shall deem proper, and by counsel

Exhibit No. 1—(Continued)

designated by Reyes Company, but at the sole expense and cost of Reyes Company; and Title Insurance and Trust Company shall not incur any expense of such character unless authorized thereto in writing by Reyes Company, so long as it has ample security in its hands to cover any such claim. In the event of dissolution of the Reyes Company the notice to it herein provided shall be thereafter sufficiently given to all of its successors by delivery thereof to such single person or corporation as the majority of such successors shall from time to time designate in writing therefor, and in default of such designation shall be sufficiently given by delivery thereof to Francis Land Company; and upon such dissolution such majority of such successors shall have the rights to be exercised by the Reyes Company with respect to the employment of counsel to resist any such tax claim or to authorize resistance thereof by Title Insurance and Trust Company. If and to the extent that any such claim for such taxes shall become an absolute and fixed liability, finally payable by said Title Insurance and Trust Company, either because of failure of Reyes Company so to contest the same, or upon final determination of such contest adverse to the taxpayer, and if Reyes Company shall fail to pay and discharge the same within fifteen (15) days thereafter, Title Insurance and Trust Company may resort to the security aforesaid for payment thereof, and for such purpose may sell so much of said security as shall be necessary therefor and to satisfy the

Exhibit No. 1—(Continued)

amount so payable upon such claim, with all costs, interest and penalties accrued thereon, by sale at public auction to the highest bidder, in the manner provided by law for the enforcement of pledges, and after written notice to Reyes Company given as aforesaid not less than fifteen (15) days before such sale. Resort to such security shall be had in the following order: First, any cash constituting part thereof; next, any municipal bonds constituting part thereof, and next, any corporate stock included therein. Any remaining unapplied portion of said security shall thereupon be exonerated and promptly returned to Reyes Company. If after full application of such security any deficiency shall remain on account of tax liability to which such indemnity applies, the parties hereto who are beneficially interested in said estate shall be severally personally liable and obligated for and agree to pay upon demand, such deficiency, according to and in the proportions of their respective interests in said estate; and those of them who are beneficiaries under the trust provided in section "Twentieth" of said Will hereby severally transfer, assign and set over unto said Title Insurance and Trust Company all of their respective right, title, interest and estate in and under said trust and in the assets thereof and interest in the remainder therein to secure their respective obligations for such deficiency, it being understood that such liability for such deficiency is several, and that each party shall be (and that the security so given by him shall be)

Exhibit No. 1—(Continued)

liable for only the proportionate part of such deficiency computed on the basis aforesaid; provided that unless and until there shall be occasion to resort to such security for payment of such deficiency such beneficiaries under said trust and their successors shall be entitled to receive and enjoy all of the income from and benefits otherwise accruing to them as beneficiaries under said trust.

So long as the Reyes Company is not in default under the provisions of this indemnity the Reyes Company shall have and enjoy all of the rights and privileges incident to ownership of the security so deposited by it, including particularly the exclusive right to vote any corporate stock included therein, and to collect all cash dividends and interest on any such stock on other securities. Provided further that (unless there shall be occasion so to resort thereto) such assignments of such interests under said trust as aforesaid, to secure such obligations for such deficiency shall be and remain effective only while and so long as Title Insurance and Trust Company shall be entitled to hold and retain as hereinbefore provided, the security for such indemnity so to be deposited by Reyes Company; and upon exoneration of said last mentioned security as hereinbefore provided, such assignments shall automatically be and become wholly ineffective.

In the event of any dissolution or corporate reorganization of any corporation whose securities are deposited as aforesaid, said securities may be

Exhibit No. 1—(Continued)

withdrawn from deposit for the sole purpose of doing all necessary acts which may be required to carry out said dissolution or reorganization, but only upon the condition that all liquidating dividends or assets distributed as a result of said dissolution, or new securities issued in lieu of said securities so withdrawn, shall be forthwith deposited with said Title Insurance and Trust Company, to be held pursuant to all the terms and provisions of this paragraph, until the terms of said indemnity shall have been fully complied with, provided that any cash so received shall upon request of Reyes Company be promptly invested by Title Insurance and Trust Company in such investments as shall then be legal investments for trust funds under the laws of California, such investment to be thereafter held by Title Insurance and Trust Company in like manner as said original security.

Upon the deposit with said Title Insurance and Trust Company of any other securities acceptable to it in lieu of the securities deposited as aforesaid, said securities so deposited may be withdrawn. All securities so substituted shall be held by said Title Insurance and Trust Company subject to all the terms, conditions and provisions of this paragraph.

Nothing in this agreement contained shall be construed to obligate the O'Melvenys, or any of them, for payment of the taxes, if any, to which the foregoing indemnity applies, as hereinbefore in this Paragraph 8 hereof provided.

Exhibit No. 1—(Continued)

9. The Executor agrees, promptly upon the execution hereof, to take and prosecute appropriate proceedings to procure approval by said Superior Court, in the proceedings therein for the administration of said decedent's estate, of this Agreement, insofar as the same affects said estate, and for authorization to said Executor to take such action as shall be necessary or appropriate on its part to the consummation hereof. The Executor agrees promptly to file and present for approval its accounts and petition for distribution, and to proceed with all reasonable speed and diligence to close and distribute said estate, all thereof in accordance herewith and with said Will and Codicil as modified hereby. The Carsons and the Watsons, the Executor and the Law Firm, agree that the Executor shall show in said accounts as paid, and the Executor is hereby directed to pay, the following commissions and fees, viz.:

In lieu of balance of statutory

Executor's commissions	\$42,000.00
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In lieu of statutory attorneys' fees

to O'Melveny, Tuller & Myers and Cruickshank, Brooke & Evans	77,000.00
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Special counsel fees to Cruickshank,

Brooke & Evans	10,000.00
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Special counsel fees to

Joseph L. Lewinson	39,177.55
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Exhibit No. 1—(Continued)

Special counsel fees to Gibson,

Dunn & Crutcher\$ 39,177.55

Special counsel fees to

Dempsey & Mackay 2,500.00

The Executor and the Law Firm covenant and agree that there will be no charge against or payable from said probate estate for Executor's commissions or attorneys' fees or other legal expenses, except as hereinabove provided, and the Carsons and the Watsons agree that the accounts of the Executor may be settled on said basis; provided, however, that if any actions or proceedings are instituted by or against the Executor or as to which it is a proper party prior to the decree of final distribution, or if any appeal is filed with respect to any order or decree made in said estate that are not now in contemplation of the parties and are not now foreseeable, then the Executor shall be entitled to its reasonable costs, expenses and compensation, including reasonable attorneys' fees incurred in connection therewith, whether by court action or otherwise.

The Carsons and the Watsons, and each of them, by these presents approve the accounts and supplemental accounts of the Executor heretofore filed in said probate proceeding, and waive the right of appeal from any court order approving them, or any of them. And the Carsons and the Watsons, and each of them, by these presents release Title

Exhibit No. 1—(Continued)

Insurance and Trust Company, individually and as Executor, from any and all claims, demands, actions or causes of action, and suits at law or in equity, that they have, or may have, by reason of any act or omission of said Title Insurance and Trust Company done or suffered as Executor of said estate during the period covered by its accounts filed in said proceeding as aforesaid.

The Carsons and the Watsons, and each of them, waive any right of appeal from any decree of distribution which shall be made in said estate proceedings pursuant to and in accordance herewith; and they likewise waive any right of appeal from any order made by said Court pursuant hereto in so far as the same shall approve this agreement and authorize said Executor to proceed hereunder.

10. Said Executor further covenants that promptly upon distribution, pursuant to said Will and Codicil, of the shares of Reyes Company belonging to said estate, it will deliver to said Reyes Company all of the assets thereof which may be in the possession or under the control of said Title Insurance and Trust Company, except the securities to be deposited by Reyes Company as provided in Paragraph 8 hereof.

11. The O'Melvenys and the Law Firm covenant that any and all certificates representing qualifying shares of stock now outstanding of the Francis Land Company, Dominguez Estate Company,

Exhibit No. 1—(Continued)

Dominguez Wilshire Company and Dominguez Water Company standing in their names, or the names of any of them, or in the names of their employees, agents and representatives, will be properly endorsed and delivered back to the respective companies.

12. Upon and subject to full and faithful performance by the O'Melvenys of the obligations devolving upon them under the paragraphs of this Agreement designated 1 and 2, and not otherwise, the Carsons and the Watsons and said Title Insurance and Trust Company, in so far as they are, respectively, stockholders of the following named corporations, viz., Reyes Company, Francis Land Company, Dominguez Estate Company and Dominguez Wilshire Company, hereby consent to the complete release by each of said corporations of all demands which they may have against said O'Melvenys, or any of them; and (but only upon and subject to consent thereto of all other stockholders of each of said corporations executing the same) they hereby authorize and direct those of said corporations of which they are stockholders, respectively, to execute such releases, and upon such condition, covenant and agree to vote all shares in said corporations directly or indirectly controlled by them accordingly.

13. The parties hereto agree that each will, at any time, make, execute and deliver all instruments, conveyances, powers of attorney, authorizations and

Exhibit No. 1—(Continued)

all other documents as the other of them, their executors, administrators, successors or assigns, shall reasonably require for the purpose of giving full effect to this Agreement and its conditions, covenants, agreements and provisions herein contained; provided, however, that no party shall be required to sign any instrument which will in any manner require the party signing to pay any money or incur any obligations or liability other than as provided in this Agreement.

It is mutually understood and agreed by all parties hereto that for the purpose of procuring a decree of distribution in said estate which shall conform to the terms of this Agreement, this Agreement when operative shall be and operate in lieu of any transfer or assignment which might otherwise be required of any party hereto for the purpose of giving full force and effect to this Agreement in said decree of distribution, and each of the parties hereto hereby does so transfer and assign.

14. And further in consideration of, but only upon and subject to the performance by the O'Melvyns of all of the obligations developing upon them under the paragraphs of this Agreement designated 1 and 2, the Executor (subject further to the approval of this Agreement and authorization therefor by said Court), the Reyes Company and the Carsons and the Watsons, and each of them; (individually, as heirs and legatees and/or

Exhibit No. 1—(Continued)

transferees of Maria De Los Reyes D. De Francis, as heirs of Guadalupe Dominguez, deceased, as stockholders of the Dominguez Estate Company, Francis Land Company and Reyes Company, and in any and all capacities whether like or unlike the foregoing) do hereby, each for himself or itself, further covenant and agree to and with the O'Melvenys and the Law Firm as follows:

(a) That he or it will not, either alone or in conjunction with any other or other of those joining in this covenant, at any time, or in any court, directly or indirectly, institute, maintain, or allow the use of his or its name for the institution or maintenance of any action at law or suit in equity, or special proceeding against the O'Melvenys and the Law Firm, or any of them, upon any demand, claim, action or cause of action hereinbefore in the paragraph hereof designated 5 mentioned and so agreed to be released, and subject only to such performance by the O'Melvenys, this covenant not to sue shall be deemed fully effective, irrespective of any question as to the effectiveness of such release; and

(b) That he or it will not, either alone or in conjunction with any other or others of those joining in this covenant, at any time or in any court attack or seek to invalidate the O'Melvenys' right to transfer, as hereinbefore provided, said shares of Francis Land Com-

Exhibit No. 1—(Continued)

pany and of Dominguez Estate Company, and their title thereto at the time of such transfer, in such manner as thereby to create liability on the part of the O'Melvenys under their representation, covenant and agreement aforesaid, if such title, and in consequence thereof, the title of such transferees and purchasers thereof from the O'Melvenys, shall not be otherwise attacked, questioned or disputed; that is to say, the parties hereto will not, directly or indirectly, initiate such attack or question such title so long as the same shall not be otherwise questioned; but this provision is not intended, and shall not be construed, to impair, limit or restrict such representation, covenant and agreement of the O'Melvenys with respect to the shares so to be transferred and sold, or the right of any of the parties hereto to enforce the same by any and all appropriate means, and, as an incident thereto, to question such title of the O'Melvenys, if such title is attacked by parties other than the parties hereto.

15. The undersigned Carsons and Watsons (in whatever capacity they may occupy with respect to Reyes Company), and Title Insurance and Trust Company, hereby consent to and direct the distribution of all the assets of, and dissolution of said Reyes Company, within a reasonable time after the date hereof; and with this end in view hereby agree

Exhibit No. 1—(Continued)

to take all necessary steps to accomplish such distribution and dissolution, including the signing of any and all consents, directions to directors, voting in favor thereof as stockholders and/or directors or otherwise; and hereby covenant not to take any action to prevent said distribution or dissolution. This agreement shall be construed as a direction to the officers and directors of Reyes Company to proceed with said distribution and dissolution and a consent by the stockholders thereto. Upon any such distribution all assets other than cash shall be distributed ratably in kind.

16. For the convenience of the parties, this Agreement shall be consummated through an escrow with said Title Insurance and Trust Company, which shall be deemed open upon the execution hereof, and, so far as reasonably possible, performance hereof shall be had through such escrow, and to such end, subject always to the conditions hereof, the parties respectively agree promptly to deposit therein the things required of them hereunder, with appropriate instructions for use thereof in accordance herewith.

17. This Agreement and each any every covenant hereof shall be binding upon and inure to the benefit of the parties hereto, their heirs, executors, administrators, successors and assigns. This Agreement may be signed in counterpart, each of which shall be deemed an original.

In Witness Whereof, the corporate parties hereto

Exhibit No. 1—(Continued)

have respectively caused their corporate seals to be hereto affixed, and this instrument to be executed in their behalf by their undersigned officers thereunto duly authorized, and the other parties hereto have executed the same, all thereof as of the day and year first above written.

/s/ HENRY W. O'MELVENY,
/s/ STUART O'MELVENY,
/s/ JOHN O'MELVENY,
/s/ DONALD O'MELVENY,

By JOHN O'MELVENY,
His Attorney in fact.

/s/ ISABEL WATSON O'MEL-
VENY,

/s/ PHILA MILLER O'MELVENY,
By JOHN O'MELVENY,
Her Attorney in fact.

As Parties of the First Part, sometimes herein collectively designated as "O'Melvenys";

/s/ EDWARD A. CARSON,
/s/ DAVID A. CARSON,
/s/ JOSEPH N. CARSON,
(also known as Joseph Carson)

/s/ VIRGINIA CALDWELL,
/s/ LUCY RASMUSSEN
/s/ AMELIA ATHERTON DRUDIS
/s/ VICTORIA L. COTTON
/s/ VALERIE C. HANRAHAN

Exhibit No. 1—(Continued)

/s/ GLADYS C. SCHELLER

/s/ JOHN VICTOR CARSON

/s/ GEORGE EARL CARSON

(also known as G. Earl Carson
son and as Earl Carson)

As Parties of the Second Part, sometimes herein collectively designated as "Carsons";

/s/ ROBERT L. WATSON,

/s/ GRACIA WATSON ROLLINS,

/s/ CHARLES I. BAKER,

Trust Officer, (Title Insurance and Trust Company, as Assignee of and Trustee for Gracie Watson Rollins)

/s/ LUCILE WATSON MARTIN,

/s/ ANITA WATSON

A. L. W.

/s/ ALPHONSE (LOUIS)
WATSON

/s/ JOHN F. WATSON

/s/ VICTORIA LIMACHER

/s/ LAVENA WATSON BROWN,

By /s/ ALPHONE LOUIS WATSON,

Her Attorney in fact.

/s/ WATSON JARRETT,

JARETT ESTATE COMPANY,

a corporation (as successor of Watson Jarrett
and Dudley Jarrett)

Exhibit No. 1—(Continued)

[Seal] WATSON E. JARRETT,
 President,

 H. H. JARRETT,
 Secretary.

As Parties of the Third Part, sometimes herein
collectively designated as “Watsons”;

[Seal] REYES-DOMINGUEZ COMPANY,
 a corporation,

 By H. H. COTTON,
 President,

 And FRED DREW,
 Secretary.

As Party of the Fourth Part, sometimes herein
designated as “Reyes Company”;

[Seal]
TITLE INSURANCE AND TRUST COMPANY,
individually and as Executor of the Will of
Maria De Los Reyes D. De Francis, Deceased,
and as Trustee designated by said Will in
respect of the trusts declared therein,

 By CHARLES I. BAKER,
 Vice-President,

 And ROBERT A. BRANT,
 Secretary.

As Party of the Fifth Part, sometimes herein
designated, according to the capacity in
which it is referred to, as “Executor” or
as “Trustee”;

Exhibit No. 1—(Continued)

/s/ H. W. O'MELVENY,

/s/ JOHN O'MELVENY

/s/ WALTER K. TULLER

/s/ LOUIS W. MYERS

/s/ PAUL E. SCHWAB

/s/ PAUL FUSSELL

/s/ WILLIAM W. CLARY

/s/ JAMES L. BEEBE

/s/ HARRY L. DUNN,

/s/ PIERCE WORKS

Copartners under the firm name and style of
O'Melveny, Tuller & Myers, together with
all associate attorneys regularly employed by
said Copartners,

As Parties of the Sixth Part, sometime herein
designated as "Law Firm".

This is to certify the foregoing has been compared with an executed duplicate of the original agreement on file in the office of Title Insurance and Trust Company and is a true copy thereof.

July 18th, 1936.

[Seal] /s/ ANGUS HENDERSON,
Notary Public in and for the County of Los Angeles,
State of California.

EXHIBIT 2

Information Schedule

Reference is hereby made to a Property Settlement Agreement, copy of which is hereto attached and made a part of this return, and as additional information the following is submitted.

First party transferred to second party under the terms of the agreement, property of the following description and approximate values:

Nominal value residue Francis Estate (assignment attached)	\$	1.00
215 shares Watson Land Co.....		86,548.25
Cash		1,500.00
50 shares Dominguez Estate Co.....	\$50,000.00	
Less related liability of.....	8,000.00	42,000.00
28 shares Reyes-Dominguez Company.....		34,433.84
Household furniture		1,000.00
Ford Sedan		500.00
Total		\$165,983.09

The parties to the agreement believe that the transfer of said property at said approximate values represents not to exceed a reasonable provision for and discharge of the legal obligations of the first party to second party and that therefore the transfer was not a transfer without an adequate and full consideration in money or money's worth.

Property Settlement Agreement

This Agreement, made and entered into this 26th day of February, 1936, by and between John F. Watson, hereinafter referred to as first party, and Helen R. Watson, hereinafter referred to as second

Exhibit No. 2—(Continued)

party, each and both residents of the County of Los Angeles, State of California.

Witnesseth That

Whereas, the parties hereto did intermarry over fifteen years ago and ever since have been and now are husband and wife, and

Whereas such unhappy differences have arisen between the said parties that it seems to both of them inadvisable for them to continue their marital relation and to live together as husband and wife, and

Whereas on account thereof the parties mutually desire to make a full, complete and final settlement of their various property rights, obligations and rights of inheritance,

Now Therefore, it is hereby agreed by and between the parties hereto as follows:

I.

The first party has paid to the second party the sum of One Thousand Five Hundred (\$1,500.00) Dollars, receipt of which is hereby acknowledged.

II.

The first party agrees to deliver and transfer to the second party within thirty (30) days from the date hereof the following stocks and securities:

1. 215 shares capital stock of the Watson Land Company, clear of all encumbrance.
2. 25 shares capital stock of Dominguez

Exhibit No. 2—(Continued)

Estate Company, clear of all encumbrance.

3. 25 shares capital stock Dominguez Estate Company, subject to an indebtedness of \$8000.00 for payment of which said stock is pledged as security.

4. 28 shares capital stock Dominguez Reyes Estate Company, free and clear of all encumbrance.

III.

First party has delivered to the second party, and she has now in her possession, all of the household furniture, equipment and furnishings now owned by said parties, and it is mutually agreed that from this date forth all such property shall be and become the sole and separate property of the second party.

IV.

The first party has delivered to the second party, and the second party now holds one Ford Sedan, and it is mutually agreed that the same shall from this date forth be and become the sole and separate property of the second party.

V.

The first party acknowledges receipt and possession of one Ford house-car and one Ford Coupe, and it is mutually agreed that both of said automobiles shall from this date forth be and become the sole and separate property of the first party.

Exhibit No. 2—(Continued)

VI.

It is mutually agreed that the second party shall assume and become solely responsible for the lease which both parties have executed upon that certain house known as #1070 Atchison Street, in Altadena, Los Angeles County, California, it being further mutually agreed that the second party shall have the sole and exclusive right to use and occupy said premises under the terms of said lease, or to make such other disposition thereof as the second party may desire.

VII.

It is mutually agreed that all other property of every kind and character now owned or hereafter acquired by the first party shall be and become his sole and separate property from this date forth, and that all property which the second party may hereafter acquire or may now have in her possession shall be and become her sole and separate property from this day forth.

VIII.

For and in consideration of the foregoing, each of the parties hereto agrees to and does hereby release and discharge the other from any and all claims, demands and liabilities of whatsoever kind or nature and for support or maintenance or alimony arising by any reason from the marital relations of the parties hereto or otherwise, except in this agreement expressly set forth. Said parties

Exhibit No. 2—(Continued)

hereto do each further agree to and do hereby assign, transfer, relinquish and waive unto the other all of his or her rights in or to all property, acquisitions and earnings of the other of whatever type or nature and wheresoever situated, whether the same be community or separate property and whether the same may be in the possession or hereafter acquired. Each of the parties hereto further agrees to and does hereby waive and relinquish to the other all of his right or her right, title and interest in their claims upon or against the estate of the other and all rights of inheritance to or from the other or the estate of the other and all statutory right to administer the estate of the other.

IX.

It is further expressly understood and agreed that neither party shall at any time be required to pay unto the other party any sum whatever for alimony, support, maintenance, attorney fees, court costs or for any other purpose whatsoever in addition to those hereinbefore expressly set forth.

X.

Each of the parties hereto mutually covenant and agree to execute such deeds, assignments, conveyances or other documents as may be necessary to fully transfer and convey the property hereinbefore mentioned and any and all other property which either party may hereafter acquire from time to

Exhibit No. 2—(Continued)

time to the end that a marketable title to any such property may be given, and without further consideration or compensation.

XI.

It is further mutually agreed that this property settlement may be filed or recorded and used in any court proceeding that may arise between the parties, and that in any divorce proceeding or proceeding for separate maintenance may be used as evidence of a conclusive property settlement agreement between the parties here to.

XII.

Each of the parties hereto certifies that he or she has fully read the above and foregoing agreement and is familiar with the contents and effects thereof, and that he or she executes the same freely and voluntarily, and after being fully advised and in so doing understands and intends the same shall constitute and be and is a full, final and complete settlement of all the property rights of the parties hereto, and that the within writing contains the entire agreement of the parties hereto.

In Witness Whereof the parties hereto have hereunto set their hands and seals the day and year in this agreement first above written.

Second Party.

First Party.

Exhibit No. 2—(Continued)

State of California,

County of Los Angeles—ss.

On this 26 of February, 1936, before me, the undersigned, a Notary Public in and for said County and State, residing therein, duly commissioned and sworn, personally appeared John F. Watson known to be to me the person whose name is subscribed to the within instrument, and acknowledged to me that he executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

Notary Public in and for said
County and State.

State of California,

County of Los Angeles—ss.

On this 26 day of February, 1936, before me, the undersigned, a Notary Public in and for said County and State, residing therein, duly commissioned and sworn, personally appeared Helen R. Watson, known to me to be the person whose name is subscribed to the within instrument, and acknowledged to me that she executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

Notary Public in and for said
County and State.

EXHIBIT 3

This Agreement made and entered into this 3rd day of October, 1940, by and between

Louisa Watson and Susana Watson Lacayo, as Executrixes of the Last Will and Testament of Robert Lee Watson, deceased, hereinafter referred to as the First Parties

and

J. R. Lacayo, hereinafter referred to as the Second Party,

Witnesseth:

Whereas the Second Party has made demand upon First Parties for the transfer to him of two and two-thirds ($2\frac{2}{3}$) shares of the stock of the Francis Land Company, a California corporation, and two and seven-twelfths ($2\frac{7}{12}$) shares of the stock of the Watson Land Company, a California corporation, together with dividends paid thereon subsequent to December 19, 1935, which shares now stand in the name of First Parties, as such Executrixes; and

Whereas the basis for such claim is a gift made on December 19, 1935, by the decedent, Robert Lee Watson to Second Party; and

Whereas the First Parties were also donees under said gift and of the same properties given to Second Party, though in different proportions, and under which gift, on the petition of First Parties, certain shares of stock in said corpora-

Exhibit No. 3—(Continued)

tions and the dividends paid thereon, have been ordered transferred and paid, respectively, from said Estate to the First Parties, in certain individual shares, as in said order more particularly set forth, reference to same being hereby made for all further particulars thereof; and

Whereas, by reason thereof and by reason of their knowledge of the facts surrounding the making of said gift, First Parties recognize the fact that said gift was made and the justice of the claim so asserted by Second Party; and

Whereas, since First Parties and/or the Estate of which they are Executrixes would therefore have no defense to an action brought to compel the conveyance to Second Party of said shares and the payment of said dividends and that any such action would only result in unnecessary costs, expenses and delay;

It is therefore hereby mutually agreed as follows:

First Parties, in consideration of Second Party withholding and waiving his right to bring any action for the transfer of said shares to him and for the payment to him of said dividends, and in recognition of the gift so made by said Robert Lee Watson, as aforesaid, hereby agree to transfer to said Second Party the number of shares in each of the above named companies, respectively, as hereinbefore set out, and to pay to said Second Party all dividends received on said shares, directly or indirectly, either by said Robert Lee Watson

Exhibit No. 3—(Continued)

in his lifetime, or by his Estate subsequent to his death, and Second Party, in consideration of the receipt of a certificate in each of said Companies for the number of shares as aforesaid, and of the payment to him of said dividends, hereby promises and agrees to withhold and waive any right of action against said Executrixes and/or the Estate of said Robert Lee Watson for the transfer of said shares in said companies, or either of them, to Second Party and for the payment to him of the dividends thereon, and hereby acknowledges full satisfaction of all claims of every kind and character against said Executrixes and/or said Estate by reason of the gift so made to him as aforesaid.

It is further agreed that the dividends hereinbefore referred to and due hereunder are as follows:

On the stock of the Francis Land Co., \$799.15

On the stock of the Watson Land Co., \$169.87

In Witness Whereof the parties hereto have hereunto set their hands the day and years first hereinabove written.

LOUISA WATSON,
SUSANA WATSON LACAYO,
Executrixes of the Last Will and Testament of
Robert Lee Watson, deceased,
First Parties.

J. R. LACAYO,
Second Party.

EXHIBIT 21

This Indenture of Lease, made and entered into in duplicate this 31st day of August, 1923, by and between Maria De Los Reyes D. De Francis, a widow, of Los Angeles, California, hereinafter called the "Owner," and Union Oil Company of California and Shell Company of California, corporations, hereinafter called "Lessee",

Witnesseth

That for and in consideration of the sum of Ten Dollars (\$10), lawful money of the United States of American, paid by the Lessee to the Owner, the receipt of which is hereby acknowledged, and for other consideration, the receipt of which is hereby acknowledged, and for and in consideration of the covenants to be kept, the acts to be performed, and the rents and royalties to be paid by the Lessee to the Owner, as hereinafter specified, the Owner does hereby lease, demise and let unto the Lessee, their successors and assigns, and the Lessee hereby takes and accepts from the Owner, for the term and time, and for the purposes, and under and in accordance with the stipulations, agreements and conditions hereinafter set forth, that certain real property situate in the County of Los Angeles, State of California, and more particularly described as follows, to-wit:

Situate in the Rancho San Pedro, in the county

Exhibit No. 21—(Continued)

of Los Angeles, state of California, and more particularly described as follows, to-wit:

Commencing at a post in the Southeast corner of the 200-acre tract known as the "Homestead of Guadalupe, Susana and Reyes Dominguez," as shown upon a map filed by the Commissioners in Partition in Case No. 3284, files of the Superior Court of Los Angeles County, and running thence along the Southern boundary thereof S. 88 deg. W. 45.59 chains to the post in the Southwest corner of said tract; thence along the West boundary thereof N. $81\frac{1}{4}$ deg. 44.73 chains to the post in the Northwest corner of said tract and in the Southwest corner of the Homestead Tract of Victoria D. de Carson; thence along the Western boundary of the latter N. $81\frac{1}{4}^{\circ}$ E. 3.45 chains to a post in the South line of Victoria Street; thence along said line S. 88° W. 114.39 chains to a post in the Northeast corner of the Highland Tract of 500 acres of Victoria D. de Carson; thence along the same South 50.18 chains to the Southeast corner thereof; thence South 3.14 chains along the Highland Tract of Guadalupe Dominguez to a post; thence along the same Tract N. 88° E. 152.20 chains to the West line of Railroad Avenue, a point 100 feet Westerly from the middle of the Los Angeles and San Pedro Railroad; thence parallel to said Railroad N. $81\frac{1}{4}^{\circ}$ E. 6.04 chains to the place of beginning containing 616.40 acres, excepting, however, so much of Wil-

Exhibit No. 21—(Continued)

mington Avenue as runs over this tract, being a strip of land 53.52 chains long, and one chain wide, and containing 5.35 acres, having a balance of 611.05 acres in this allotment—being the tract of land known as the “Highland Tract,” allotted to Maria de Los Reyes Dominguez, as shown upon a map filed by the Commissioners in Partition in Case No. 3284, files of the Superior Court of Los Angeles County, to which map and the record of the final decree therein reference is hereby made.

Saving, excepting and reserving, however, from said tract of land the following, to-wit:

1st. Beginning at the intersection of the southerly boundary line of the Maria de Los Reyes Dominguez de Francis 611.05 acre allotment in the partition of the Ranch San Pedro as per Superior Court Case No. 3284, Records of Los Angeles County, with the Westerly boundary line of the right-of-way of the Pacific Electric Railway Company, thence northerly along said westerly boundary line a distance of 398.64 feet more than less to the southerly boundary line of the Reyes, Guadalupe and Susana Dominguez 200 acre allotment in the partition above referred to; thence westerly along said southerly boundary line of said 200 acre tract a distance of 2895.54 feet more or less to the southwest corner thereof; thence southerly and parallel to the right-of-way of the Pacific Electric Railway Company above referred to, a distance of 398.64 feet more or less to the southerly boundary

Exhibit No. 21—(Continued)

line of the said Maria de Los Reyes Dominguez de Francis 611.05 acre allotment; thence easterly along said southerly boundary line a distance of 2895.54 feet more or less to the point of beginning. Containing 26.22 acres.

2nd. A portion of that parcel of the Dominguez Estate containing 611.05 acres which was allotted to Maria de Los Reyes Dominguez (de Francis) in the Dominguez Partition of 1884, described as follows:

Beginning at the Northwest corner of said tract, being a point on the east line of the Wilmington Road 2146.0 feet South of its intersection with the south line of Victoria Street and from which the southwest corner of the 200 acre tract allotted to Reyes, Guadalupe and Susana Dominguez in the said Dominguez Partition bears South $68^{\circ} 35'$ East, 2474.96 feet; thence East 526.96 feet to the Northeast corner; thence South 510 feet to the Southeast corner; thence West 498 feet to the Southwest corner; thence North $3^{\circ} 15'$ West 510 feet along the east line of the Wilmington Road to the Northwest corner, the place of beginning, containing 6.00 acres of land.

3rd. 50 acres of land situate in the southeast corner of said 611.05 acre tract described as follows:

Bounded on the South by the south line of said 611.05 acre tract; bounded on the East by the west line of the Homestead Tract extended so as to intersect the said south line of the said 611.05 acre

Exhibit No. 21—(Continued)

tract; bounded on the North by a line running East and West through the center of said 611.05 acre tract; bounded on the west by a line parallel to the west line of the Homestead Tract and at such a distance therefrom as to include 50 acres of land. Together with the exclusive right, subject to the terms, provisions and conditions hereof, to explore and drill for, develop, collect, obtain, take, save, remove, market and otherwise use, enjoy and dispose of any and all kinds of crude petroleum oil, gas and any and all hydrocarbon substances in, upon, out of, and from said lands; together also with the right, subject to the terms, provisions and conditions hereof by and with any and all improvements and appliances, to use and enjoy the necessary rights-of-way for ingress and egress into, upon and across said land for the operation thereof under this indenture; together also with the right, subject to the terms, provisions and conditions hereof, to build, erect, operate, maintain and enjoy roads, derricks, rigs complete, boilers, tanks, tank houses, bunk houses, pumping stations, pipe lines, telephone, power and light lines, and other structures, apparatus and equipment suitable for use in connection with the drilling for, developing, collection and transportation on said lands of said substances produced hereunder. Provided, however, that no topping plant, of any kind of manufacturing or refining plant, other than a gasoline extraction plant or plants, an oil dehydrating or cleaning plant or plants, and a plant or plants for topping

Exhibit No. 21—(Continued)

or refining or otherwise treating the oil or gas produced from said leased premises, shall be installed on said land without the written consent of the Owners first had and obtained. Further provided, that all roads shall adapt themselves so far as practicable to the present and subsequent uses of the land by the Owner; for example, if any of the land shall be surrendered and subsequently subdivided, the Lessee shall use any roads or streets made in such subdivision where such is practicable, and any roads used by the Lessee shall be located where they shall be least detrimental to the use of said leased lands permitted to the Owner.

Said lease is made subject to the following encumbrances, to-wit:

First. All taxes for the fiscal year 1923-1924 which the Owner agrees to pay.

Second. All existing farming leases whether of record or not.

Third. Easements for pipe lines, irrigating ditches and canals, pole lines, roads and highways, whether of record or not.

Said lease is made for the term and upon the conditions and agreements hereinafter set forth, and the Owner and Lessee respectively agree to take and perform the respective conditions and agreements to be kept and performed by them respectively, as follows, to-wit:

Exhibit No. 21—(Continued)

I.

Possessory Rights:

The possession by the Lessee of the leased lands shall, subject to the aforesaid encumbrances, be sole and exclusive, excepting only that the Owner reserves the right to occupy and use, either in person or by tenant, the surface of the leased lands or any part thereof for residence, agricultural, horticultural or grazing purposes in so far as the same shall not at the time interfere with the rights and operations of the Lessee. The Lessee agrees to conduct its operations so as to interfere as little as practicable with the reserved uses of said leased lands from time to time, bearing in mind the Lessee's paramount right to obtain and remove oil and other hydrocarbon substances at the place or places best adapted therefor.

II.

Lessee Duties Relative to Surface Rights:

The Lessee shall pay to the Owner a reasonable cash sum for all damages to pipe lines, canals, buildings, and other structures, and for trees and growing crops on the leased lands destroyed or injured by reason of its operations under this lease. If the parties in interest are unable to agree upon the amount of such damage, then each party shall within ten days after written notice by either of them to the other demanding arbitration, select and in writing notify the other party of the name

Exhibit No. 21—(Continued)

of an arbitrator and the two arbitrators so selected shall choose a third and such three arbitrators shall examine the property and consider any matters submitted to them by the parties, and make a written award of the amount of such damages, which award of a majority of said arbitrators shall be finally binding and shall be paid in money by the Lessee within thirty days after being served with a copy thereof.

The Lessee agrees to save and hold the Owner harmless against and from the claims of any of the present tenants, arising on account of the Lessee's operations under this instrument. The Lessee shall lay its pipe lines which run across cultivated areas so that the top thereof shall be at least eighteen inches below the surface of the soil, and whenever so requested by the Owner shall, with reasonable diligence, erect physical evidences, such as posts or monuments, to show the line of demarcation of the land exclusively needed by it around each well dug by it and the land covered by any sump hole or used by it and the land required for use for tanks, reservoirs, boilers, pump houses and other buildings or works.

The Lessee may from time to time designate by written notice to the Owner and by appropriate posts or monuments placed upon the ground any land not exceeding five acres in area about any proposed well, tank site, building, or other works, the exclusive possession of which will be required

Exhibit No. 21—(Continued)

by the Lessee in its operations hereunder, and also the location of any proposed roadway or other right-of-way, across the lands hereby leased, and the Lessee shall not be liable for any damages to crops or improvements planted or placed upon the lands so designated after such designation is made. It being understood, however, that the Lessee shall include within any such designated area only such lands as may be reasonably required and used by the Lessee for its works and operations thereon.

III.

Water Rights:

The Lessee shall be entitled to use, free of charge in connection with its operations under this lease any water it may develop upon the leased lands. If and while the Lessee does not use the same in its operations, the Owner may use it for her surface operations, or grant the same to the Dominguez Water Company with such easements for rights of way as may be necessary for its use, nevertheless said grant shall be subordinate to the terms of this lease, without expense to the Lessee. In the event that any well drilled by the Lessee on the leased lands shall be abandoned by it and there has been water encountered in such quantities as might make pumping thereof practicable, the Lessee shall permit the necessary casing therein to remain therein for a period of thirty (30) days after written notice from the Lessee to the Owner, and during such

period the Owner shall have the right to purchase said casing at seventy-five (75) per cent of its then cost price at the well.

IV.

Twenty-Year Term and Rights of Lessee

Thereafter:

The term of this lease shall be twenty years from and after the date hereof and for so long thereafter (but not exceeding twenty additional years) as oil, gas or other hydrocarbon substances shall be produced and saved from said leased lands in commercially paying quantities.

At the expiration of said twenty-year drilling period, all undrilled lands shall be free from the terms and conditions of this indenture; provided that the Lessee shall have full right to retain, operate, redrill, clean out, deepen, repair, pump and work all oil wells or gas wells or other wells or other works existing upon said leased lands at the time of the expiration of said drilling period, so long thereafter (but not exceeding twenty additional years) as oil, gas or other hydrocarbon substances shall be produced and saved from said wells or works respectively in commercially paying quantities, upon the rent and royalty and subject to the terms and conditions in this lease specified; and the Lessee shall have and retain with each such well, so long as it shall be so retained and operated, a parcel of land around each well of such size, not exceeding five (5) acres, as it may reasonably deem

Exhibit No. 21—(Continued)

necessary, and so long as any well or wells shall be so retained and operated the Lessee shall have and retain all reasonable rights-of-way for ingress and egress to and from said well or wells and full rights-of-way for its water lines, gas lines, oil lines and other pipe lines, and telegraph, light, power and telephone lines, and all other means of access, and all works and improvements useful for the operation of each of said wells, and the production, storing and/or transporting of the product thereof upon the leased lands.

Drilling Operations of Lessor:

(A) Original Exploration. The Lessee hereby undertakes and agrees to pay the Owner the sum of \$3.00 per acre on the number of acres of land hereby leased, to-wit: 528.83 acres, monthly on the first day of each and every month beginning September 1, 1923, and continuing until such time as the Lessee has commenced the actual drilling of a well for oil or gas on the demised premises under this lease.

The Lessee covenants that it will commence the drilling of a well for oil or gas on the demised premises at such time as the usual course and practice of oil companies will allow for the completion of the same by the first day of July, 1925, and when so commenced shall thereafter prosecute the drilling of said well in good faith, diligently and continuously except for excusable delays specified in clause (G) hereof until said well is completed.

Exhibit No. 21—(Continued)

The Lessee may at its option abandon the well before completion, but in that event shall commence the drilling of another in lieu thereof within ninety days after the cessation of work upon the abandoned well, and shall continue the drilling of such well in the same manner as provided for the first well until each well is completed.

If during the course of its drilling operations Lessee shall conclude that oil or gas in paying quantities will not be found on said premises, it may surrender said lands as provided in clause XIII hereof entitled "Right of Lessee to Quitclaim".

(B) Further Drilling Requirements. The Lessee further covenants that it will commence the drilling of additional wells on said demised premises within such time as the usual course and practice of oil companies will allow for the completion of two wells by the first day of July, 1926, and within such time as the usual course and practice of all companies will allow for the completion of two oil wells by the first day of July, 1927, and will each year thereafter within such time as the usual course and practice of oil companies will allow for the completion of two wells by July 1st of each succeeding year up to and including the year 1933, making in all seventeen (17) wells.

After the expiration of said period, to-wit, the drilling of said seventeen (17) wells, the Lessee covenants that it will prosecute the drilling on said property diligently and continuously until the

Exhibit No. 21—(Continued)

equivalent of one well for each fifteen (15) acres of land hereby demised shall have been completed upon said premises.

The Lessee covenants that it will prosecute the drilling of each of the wells above referred to in good faith, diligently and continuously, except for excusable delays specified in clause G hereof until said wells, respectively, have been completed.

In the event that any portion of said demised premises be released from the provisions of this lease, the number of wells to be drilled on said demised premises shall be reduced by one well for each fifteen (15) acres so released.

The Lessee may at its option abandon any well before completion, but in that event shall commence the drilling of another in lieu thereof within ninety days after cessation of work upon the abandoned well, and shall continue the drilling of the same with like diligence as required for the first well until completion.

(C) What Constitutes a Completed Well.

A well drilled hereunder shall be deemed a completed well either—

1. When the same shall have been drilled to a depth of at least three thousand five hundred (3,500) feet, and when the Lessee shall have ceased to drill therein and have abandoned the same as unsuccessful; or

Exhibit No. 21—(Continued)

2. When igneous and metamorphic rock is encountered at a lesser depth; or

3. When oil or gas shall have been found in quantities sufficient to pay to pump or otherwise secure and save, as shown by a pumping test of not exceeding thirty days, and the Lessee shall have elected, for the time, to cease further drilling in said well.

(D) Additional Wells. During the aforesaid twenty-year drilling period the Lessee may drill as many additional wells as it chooses and may redrill, deepen, repair and clean any and all wells drilled on said property.

(E) Offset Wells. In case at any time after the date of this lease, and during the twenty-year drilling period, but no longer, any well shall have been drilled upon lands in the vicinity of the leased premises and within three hundred (300) feet of any boundary line of said leased lands, and shall, when put on the pump or permitted to flow, have produced at least one hundred (100) barrels of oil per day during a thirty-day test, then the Lessee shall, within ninety (90) days after the expiration of said test, commence drilling operations for an offset well upon the leased lands (unless a well has been already drilled on the leased lands which is so located as to amount to an offset well as herein provided). Any such offset well shall be located within three hundred (300) feet of the boundary line of the leased lands and within three hundred

Exhibit No. 21—(Continued)

(300) feet of a line drawn at right angles from the well to be offset to the boundary line of said leased lands. Said offsetting requirements are, however, subject to the following conditions, namely:

First. One well, if otherwise meeting the conditions of this subsection headed "Offset Wells," may constitute an offset to two or more wells.

Second. Any such offset well shall count upon the number of wells specified to satisfy the drilling requirements set forth in subsection (B) hereof entitled, "Requirements after Discovery."

Third: The Lessee shall not be required to drill a well to offset any well drilled on adjoining lands at the time owned by the Owner.

Any offset well which the Lessee is required to commence, as aforesaid, shall be drilled and completed with reasonable diligence in the same manner as is required for other wells as set forth in this indenture.

(F) Remedy for Default. Forfeiture of Lessee's interest under this indenture to the extent and in the manner specified in section XIV hereof, entitled "Fortfeiture," shall be the sole and exclusive remedy of the Owner in respect of any default by the Lessee regarding any of its drilling obligations under this section.

(G) Excuses for Delay in Drilling. The Lessee shall not be bound to begin or carry on the work of drilling wells or other operations hereunder on

Exhibit No. 21—(Continued)

Sundays or legal holidays, nor shall it be required to work at night when it would incur risk of injury to operators or property by so doing, nor shall it be required to begin or required to carry on said drilling or other operations when prevented by acts of God or the weather or strikes, lockouts, war, unavoidable shortage of water or of materials or inability to secure proper delivery of materials, accidents or other unavoidable causes whether of the character above named or of different character.

(H) Suspension of Drilling Operations. The Lessee may suspend work of drilling any well or wells other than the first well drilled hereunder, so long as and during the time that the posted price for oil in Los Angeles County is ninety (90) cents per barrel or less for oil of the gravity of 24.9. Said base price to be modified by the differential in force at the time for oil or higher or lower gravity. Provided, however, that the Lessee shall pay to the owner the sum of \$3.00 per acre each month during the period of such suspension for the acreage contained in said demised premises, to-wit: 528.83, less 25 acres for each well then completed, or in the course of drilling and in which drilling operations are not suspended. It being understood, however, that said payment shall be reduced by the amount of royalty which shall become due and payable to the Owner during each respective month of such suspension, from the oil or gas produced from said demised lands.

Exhibit No. 21—(Continued)

(1) Allowance of Additional Time for Completion of Wells.

There shall be added to the time within which any well is required to be completed under the provisions of this lease the amount of time lost by reason of any and all excusable delays in drilling such well under paragraph (G) hereof, and the amount of the additional time required to complete such well by reason of accident or injury thereto, or in overcoming any unexpected, unforeseen or unusual difficulties in drilling, and also the amount of time during which drilling is suspended on any well under the provisions of paragraph (H) of this lease, and also in the event of the drilling of a new well in lieu of an abandoned well, the time consumed in drilling the abandoned well plus thirty days allowed for movement of rig for the commencement of a new well, shall likewise be added to the time allowed for the completion of such well.

VI.

Pumping Obligations:

Lessee shall with all proper skill and diligence and in accordance with the custom existing among skillful operators, pump and otherwise operate to their full capacity all wells drilled by it hereunder as long as the same shall continue to produce oil in commercially paying quantities. Provided, however, that the failure of the Lessee to pump or otherwise operate any well or wells shall be excused

Exhibit No. 21—(Continued)

during such time or times as the prevailing market price for such oil in Los Angeles County is ninety (90) cents per barrel or less for oil of the gravity of 24.9. Provided, further, that the obligations of Lessee to pump or otherwise operate any producing well which is an offset to a well or wells on adjoining property shall be suspended only in the event and during the time that said adjoining well or wells are not pumped or otherwise operated for the production of oil.

VII.

Lessee's Obligations Regarding Gas:

If the Lessee shall encounter a flow of oil or gas in any well subsequent to the first producing well sufficient to pay to either pump or allow the same to flow in quantities sufficient to pay to save or otherwise secure, it may, provided said gas can be disposed of or used on the leased lands. So long as said gas well or wells are used for that purpose they shall constitute completed wells in part performance of the Lessee's drilling obligations, and the Lessee may, at any time and from time to time, drill any of said gas wells deeper with the view of striking oil therein, by the Lessee shall at all times use due diligence so as not to permit undue waste of natural gas developed hereunder.

VIII.

Rental and Royalties:

The Lessee shall turn over to the Owner and the

Exhibit No. 21—(Continued)

Owner shall have, receive and accept as rental and royalty for said leased lands, free of cost (excepting as elsewhere in this section provided) the equal one-sixth ($1/6$ th) part of all the oil or other hydrocarbon substances (other than gas or gasoline, specific provision of which is made elsewhere in this section) produced and saved from said leased lands by the Lessee. The Owner shall have the option to take her royalty in kind, and if she so elects, the same shall be delivered as produced and saved into tanks or other containers upon said leased lands by the Lessee for that purpose, and such royalty oil may be stored without charge in such tanks or containers for a period of not to exceed thirty days, but at said Owner's sole risk. The Lessee shall be under no obligation to furnish or provide storage for the royalty oil for any time or at all longer or other than as hereinabove provided for said period of free storage; but if any royalty oil of the Owner shall remain in the storage tanks of said Lessee after the expiration of said term of free storage, the Owner shall pay to the Lessee storage thereon at the rate of one cent (1c) per barrel each month of said excess time. Nevertheless, after the expiration of said term of free storage, the Owner shall, on the written demand of the Lessee and within ten (10) days after such demand, receive and remove from the Lessee's storage royalty oil (or the commingled equivalent thereof) then therein, and which shall have been in storage longer than the period for such free storage; and in the event of the failure

Exhibit No. 21—(Continued)

or refusal of the Owner to receive and remove any royalty oil so required to be removed, as aforesaid, within said ten (10) days, then the Lessee shall have the right either to sell or to purchase said royalty oil affected by such demand, at the market price then current in the vicinity of the leased lands. The Lessee shall in such case pay the proceeds of the royalty oil so sold to the Owner on or before the 30th day of the calendar month next succeeding that in which it shall have been so sold or purchased.

The Owner may construct, operate and maintain upon the leased lands storage tanks, reservoirs, well houses and pipe lines or other means of conveyances for the transportation of her royalty products from said lands, provided, however, that the same shall be so constructed, operated and maintained as to interfere as little as practicable with the operations of the Lessee.

At the Owner's option the Lessee will purchase said royalty oil from the Owner and shall pay the Owner therefor the market price for oil of like grade and gravity at the wells of production in the general vicinity, and if there be no such price, then the price to be paid shall be fixed by mutual agreement, and if the parties cannot agree, then the Owner shall take her royalty in kind. From time to time whenever the Owner exercises her option with reference to the delivery of her royalty in kind, or to receiving payment therefor from the Lessee, as above provided, the Owner shall give to

Exhibit No. 21—(Continued)

the Lessee in either case ninety (90) days' written notice of her exercises of such option. In the event that the Lessee shall treat or cause to be treated its share of the oil produced from said premises for the purpose of cleaning the same or separating foreign matter therefrom, it will, if requested so to do by the Owner, likewise treat the Owner's royalty oil, and in that event the Owner shall pay the actual cost to the Lessee of treating said royalty oil.

The Lessee shall also pay to the Owner one-sixth (1/6th) of all sums received from any and all gas produced upon and from said leased lands and marketed or sold by the Lessee.

In the event that the Lessee shall not sell said gas upon the leased lands the Owner may elect from time to time to take her royalty gas, to-wit, one-sixth (1/6th) thereof, in kind at the well or from any transportation line of the leased lands. The Owner shall have the right at her own cost and risk, in the event there is gas produced on the leased lands in excess of the needs of Lessee in carrying on its operations hereunder to take from a point or points in the leased lands reasonably designated by the Lessee, and to use, free of charge, such excess gas as she may require for domestic use on the leased lands or for use at any pumping plant installed upon the leased lands; provided that if the Lessee shall extract or cause to be extracted gasoline or other products from the gas produced from said premises, then the gas taken by the

Exhibit No. 21—(Continued)

Owner shall be dry or treated gas, and shall be charged against royalty on gas produced and saved.

In the event that the Lessee shall either itself or by contract make upon the leased lands gasoline from its share of the gas, oil or other hydrocarbon substances produced from the leased lands then the Owner shall have the right to have her royalty products treated in like manner and to receive one-sixth of the market value of such gasoline at the place of production less one-sixth of the total cost of manufacturing the same.

The Lessee shall not be required to yield royalty on any oil, gas, or other hydrocarbon substances produced by it from the demised lands and used by it for fuel, mechanical and domestic purposes and uses necessarily incident to its operation on the leased lands under this lease. All royalty products which shall be sold to or by the Lessee under the terms hereof shall be paid for by it to the Owner on or before the 30th day of the calendar month next succeeding that in which delivery of the royalty products shall have been made by it, and all royalty oil paid in kind shall be delivered to the Owner from time to time as the same is produced on said leased lands and stored and handled herein provided.

In consideration of the execution of this lease the Lessee covenants and agrees further to pay to the Owner as an additional rent or royalty, an additional one-sixth ($1/6$ th) part of all oil produced

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and saved from said leased premises by the Lessee until the value of such additional royalty paid to and received by the Owner shall equal the total sum of \$661,037.50 then to cease and terminate.

The Lessee shall purchase said additional royalty from the Owner and shall pay the Owner therefor the market value thereof at the place of production.

IX.

Logs, Measurements and Accounts:

Lessee shall keep a log and record of each well drilled on said leased lands and shall, within a reasonable time after written notice, deliver to the Owner a copy of any and every of said logs requested. Lessee shall also maintain continuously on the leased lands such gauges and devices as may be necessary for measuring all oil produced hereunder and all gas saved, and shall forthwith make and keep a record showing in detail the production of all oil produced and saved and gas marketed or transported from said leased lands. The Owner shall have the right at all reasonable times, but only in the presence of a representative of the Lessee, and in a reasonable manner, to test the correctness of such gauges and devices, and may examine and take copies of all accounts and records during business hours. Lessee shall furthermore furnish to the Owner, between the first and tenth days of each calendar month, a statement in writing of the amount of oil produced and saved from said leased

Exhibit No. 21—(Continued)

lands and the quantities of gas marketed and transported therefrom, if any, and the price received for any royalty product sold during the next preceding calendar month. The Owner shall at all times have the right to enter into and upon said lands and inspect any and all operations of Lessee upon the leased lands.

X.

Taxes:

The Owner shall, during the term of this lease, pay all taxes upon the improvements, trees and growing crops owned by her on said demised premises and upon all personal property owned by her and which may be charged against said demised premises.

The Owner shall also pay, during the term of this lease, the amount of all taxes upon said demised premises computed upon the assessed value thereof for purposes of county taxation for the fiscal year 1923-1924, and the Lessee shall pay all taxes computed upon any increase in the assessed value of said demised premises over and above the assessed value thereof for the fiscal year 1923-1924. In the event that the mineral interests are separately assessed from the agricultural or other interests the separate assessments shall be added together for the purpose of determining the total assessed value of said lands.

Each party shall pay all taxes levied upon her or

Exhibit No. 21—(Continued)

its interest in said demised premises and if either party shall pay any taxes agreed to be paid or assumed by the other party hereunder, then the party paying the same shall render a statement to the other showing the total tax and the amount thereof properly chargeable to such other party and such other party shall make payment of the amount due within thirty (30) days after presentation of such statement.

In the event that the Lessee exercises the right in clause XIII hereof entitled "Right of Lessee to Quitclaim," a proper adjustment of taxes shall be made and the Lessee shall not be called upon to pay any taxes upon the property quitclaimed or surrendered back to Owner.

In the event that a production or similar tax be levied upon the production of oil, gas or other hydrocarbon substances from or upon said demised premises, then said tax shall be borne one-sixth ($1/6$ th) by the Owner and five-sixths ($5/6$ ths) by the Lessee.

The Lessee shall pay all taxes upon the buildings, rigs, tanks, tools and other personal property and improvements and structures placed upon said demised premises by said Lessee, including taxes upon the oil stored thereon belonging to the Lessee.

The Lessee shall also pay all taxes, charges and assessments imposed by the State of California or any department of the government thereof or any governmental authority under any law or regula-

Exhibit No. 21—(Continued)

tion for the protection of oil or gas against waste by infiltration of water or otherwise, or in connection with governmental control or regulation of oil and gas resources and operations.

The above obligation to pay the excess taxes by the Lessee shall be confined to such lands as the Lessee may have in its possession. This obligation to pay taxes shall not apply to income taxes, inheritance taxes, or any other taxes except the taxes that are levied by the public authorities of the state and county. Or, if the leased premises should hereafter be included in any municipality, then it shall include municipal taxes as may be levied by said municipality.

XI. (A)

It is mutually covenanted and agreed that during the twenty-year drilling term of this lease no well for oil or gas shall be drilled either on the premises hereby leased or on premises adjacent thereto now owned by the Owner and within three hundred (300) feet of the common boundary line between said leased premises and adjoining the premises of the Owner; and in the event that the Owner conveys or leases any of said adjoining premises said conveyance or lease shall be made subject to this covenant.

This covenant shall not apply to any portion of said leased premises which may be quitclaimed or released from this lease or to the premises of the Owner adjoining thereto.

Exhibit No. 21—(Continued)

XI.

Lessee's Compliance With Special Laws:

Said Lessee hereby covenants that it shall and will use all customary skill and diligence, in a good and workmanlike manner, to shut off any water which may enter any abandoned wells which may be drilled by it on said premises, and will also use every effort to shut off any water in any well which may be drilled by it on said leased lands, and make due and proper effort, by the customary methods, to prevent water from drowning said oil territory if any be discovered by the operations hereunder, or any part thereof. And said Lessee will also employ all reasonable or customary means for draining off any salt or other water produced upon said property by its drilling operations hereunder, in any excess which may injure the agricultural value of said land.

It is further covenanted and agreed that Lessee will, at all times and at its own expense, protect and indemnify the Owner against any and all claims for damages, costs or expenses incident to any claim or claims that may be made or asserted by reason of the operations of the Lessee hereunder, under the acts of the legislature of the state of California, known as "Workmen's Compensation, Insurance and Safety Act," or any other acts kindred or similar thereto, or any amendment thereof, to the end that the Owner shall at all times

Exhibit No. 21—(Continued)

be protected and indemnified against claims of employees of said Lessee for damages for personal injuries to them while engaged in the service of the said Lessee in its operations hereunder.

Lessee shall at all time post and keep posted such notice or notices in such conspicuous place or places as the Owner may select on said premises where any work or labor is being done and performed or material used, notifying all persons that the Owner will not be responsible for any work, labor, alteration, repair, materials or construction upon said premises, and any other notices required or permitted by the laws of California, as may be signed by the Owner and delivered by her to the said Lessee for posting as aforesaid.

XII.

Liens and Litigation:

The Lessee shall not suffer or permit any laborer's or materialmen's liens, or liens of like nature, to arise or exist upon or against the leased lands or any part thereof by reason of its operations under this lease or anything that may be placed on said lands by it, and shall hold the Owner harmless against any and all such liens. In like manner the Owner shall be solely chargeable with and liable for materials and labor for her horticultural, agricultural and other enterprises permitted by this lease, and shall likewise not suffer or permit any lien to arise or exist upon or against

Exhibit No. 21—(Continued)

said leased lands or any part thereof, and shall hold said Lessee harmless against any and all such liens. The party responsible for such lien shall have the right to contest any such lien, and in the event of such contest shall not be deemed in default during the continuance of the litigation, but shall promptly pay any judgments against them or either of them or the land, in said action; or in case of appeal shall furnish an appeal bond or otherwise cause the stay of execution pending appeal, and after decision of the appeal shall promptly clear the leased lands of any adverse judgment. If either party shall be in default regarding any such lien or judgment the party not in default may, at such party's option, after five days' written notice to the party in default, elect to pay off the same and clear the leased lands therefrom, and in that event the defaulting party shall immediately reimburse the other for all sums so expended.

Each of the parties shall give the other written notice of any litigation affecting the leased lands as soon as such party shall have knowledge thereof.

XIII.

Right of Lessee to Quitclaim:

At any time after the date of this lease Lessee may at its option execute and deliver to the Owner a quitclaim deed or deeds duly acknowledged so as to be ready for recordation, quitclaiming all or

Exhibit No. 21—(Continued)

any portion of the leased lands as Lessee may select, and thereupon the lands so quitclaimed shall forthwith be released from the effect of this indenture, and none of the obligations of the parties hereto shall thereafter apply to said quitclaimed lands, except as follows, viz:

(1) Lessee may reserve and maintain across, over and along the lands so quitclaimed, any and all rights and easements for pipelines, roads, poles and wires across the parcels surrendered reasonably required for use in connection with any well or wells retained by Lessee, in which event it shall be liable for the taxes on said improvements so long as it retains them.

(2) The Owner shall not drill or excavate for oil, gas or other hydrocarbons upon said quitclaimed lands at any place nearer than three hundred (300) feet to any well which may be retained by Lessee while such well so retained shall produce oil or gas in commercially paying quantities.

(3) The rights and obligations specified in section XV hereof entitled, "Lessee's Right to Remove Equipment," etc.

If and when all the leased lands shall be so quitclaimed Lessee shall be wholly released from all obligations thereafter accruing under this lease.

Exhibit No. 21—(Continued)

XIV.

Forfeiture:

In case Lessee shall be in default in the performance of any covenant or agreement by it to be done or performed under this lease, then this lease shall, after thirty (30) days' written notice of the existence of the default, given by the Owner to the Lessee and upon failure of the Lessee to correct within said thirty (30) days, or to commence within said thirty (30) days, in good faith and continue with reasonable diligence until the default be corrected, appropriate work and effort for the correcting of its default, terminate and become null and void at the option of the Owner; and the Owner in such event may take possession of said leased lands free and clear of this lease, and Lessee shall promptly vacate and surrender said leased lands to the Owner and execute and deliver to Owner a quitclaim deed releasing all its right, title and interest in said leased lands, saving only the right to remove therefrom its property as hereinafter specified. But in the event of any such forfeiture Lessee shall have the right (subject to the terms of this lease as to royalties and other matters) to retain any well or wells theretofore completed or on which work is being done in good faith at the time of such forfeiture so long as any such well or wells shall continue to produce oil and/or gas in the quantities specified as commercially paying in section IV hereof entitled "Twenty

Exhibit No. 21—(Continued)

Year Term and Rights of Lessee Thereafter:" together with a parcel of land two hundred (200) feet square with the well in the center thereof around each such well; together with such rights of access, rights-of-way to and from such well or wells for repair, maintenance and operations, and all necessary roads, pipelines, telephone, power and light lines as may be necessary in the operations of said wells, and/or in producing, saving, collection, and/or transporting the oil, gas and/or hydrocarbon substances produced from such well or wells; and further provided, that the Owner, after reentering, shall not drill or excavate for oil, gas or other hydrocarbon substances at any place on the leased lands nearer than three hundred (300) feet of any well so retained by Lessee while such well shall produce oil or gas in the quantities aforesaid.

XV.

Lessee's Right to Remove Equipment
and Duty to Clear Premises:

All improvements, tools and equipment placed upon said leased premises by the Lessee shall be and remain the property of the Lessee and within ninety days after this lease shall have terminated as to all or any particular parcel of the leased lands, Lessee shall remove therefrom, or from the part upon which its rights shall have terminated, except as provided in clause III, all of the property of the Lessee which may be situated thereon.

Exhibit No. 21—(Continued)

Not later than the time that said Lessee removes any portion of its property from said leased land and immediately upon abandonment by it of any well or other works, Lessee shall releve the surface of the land, that is to say, shall fill up pumps and other excavations, ditches, take down derricks, remove concrete and other supports and other obstacles to agriculture and generally place the leased lands so as to conform as near as practicable to the natural contour of the ground.

XVI.

Notice:

Any notice relative to this lease from the Owner to Lessee shall be deemed sufficiently delivered if a written copy thereof be delivered addressed to Lessee at or to any bank or trust company in the county of Los Angeles as may be hereafter designated in written notice by Lessee to Owner. Any notice relative of this Lease from Lessee to the Owner shall be deemed sufficiently delivered if a written copy thereof directed to the Owner is delivered either to the Owner personally, or to The Farmers and Merchants National Bank, of Los Angeles, California, as may be from time to time designated by the Owner in writing.

XVII.

Condition of Title:

It is understood that the Owner has delivered

Exhibit No. 21—(Continued)

to the Lessee an unlimited guarantee of title made the Title Insurance and Trust Company, and that the Owner makes no express or implied covenant, warranty or representation as to the Owner's right to make this lease, the condition of the title or quiet enjoyment thereof by Lessee, all of such covenants, warranties and representations, being expressly waived.

XVIII.

Miscellaneous:

All of the provisions, covenants, agreements and stipulations contained in this lease by which either of the parties hereto is bound shall in like manner be binding upon the heirs, executors, administrators, successors and assigns of the parties so bound, and those which are for the benefit of the heirs, executors, administrators, successors and assigns of the parties so benefitted, and all such provisions, covenants, agreements and stipulations shall run with the land.

In Witness Whereof, the parties hereto have hereunto set their hands and seals the day and year first above written.

s/ MARIA DE LOS REYES D. de
FRANCIS

By /s/ H. W. O'MELVENY,
Her Attorney in Fact.

Exhibit No. 21—(Continued)

UNION OIL COMPANY OF
CALIFORNIA,

By /s/ E. W. CLARK,

Its Executive Vice-President.

By /s/ JOHN McPEAK,

Its Secretary.

SHELL COMPANY OF CALI-
FORNIA,

By /s/ G. LEGH-JONES,

Its President.

By /s/ R. A. LEWIN,

Its Secretary.

EXHIBIT 22

AGREEMENT

Whereas a certain indenture of lease dated the 31st day of August, 1923 was entered into between Marie de los Reyes D. de Francis, as owner and lessor, and Union Oil Company of California and Shell Company of California, as lessees, which indenture of lease was duly recorded on the 24th day of May, 1924, in Book 3138, Page 290, of the Official Records of Los Angeles County, said lease having been subsequently amended so as to correct the description of certain lands reserved therefrom, by agreement recorded on the 6th day of November, 1925, in Book 5175, Page 308, of said

Exhibit 22—(Continued)

Official Records of Los Angeles County. Said lease as so amended is hereinafter referred to as the "original lease." Reference is hereby made to said original lease and the record thereof for all purposes, and without limiting said general purposes, said reference includes descriptions of land leased and reserved and all covenants, agreements and obligations of the respective parties and all conditions, limitations, restrictions and reservations as in said lease expressed; and

Whereas the Dominguez Estate Company has succeeded to the title and ownership of said land in said lease described by virtue of a deed of conveyance executed by Francis Land Company, the successor in interest of Maria de los Reyes D. de Francis, to the Dominguez Estate Company; which said deed was duly recorded on the 16th day of October, 1928, in Book 7286, Page 217, of said Official Records of Los Angeles County; and

Whereas Burnham Exploration Company has succeeded to the title and ownership of an undivided one-fourth ($\frac{1}{4}$) of the undivided one-half ($\frac{1}{2}$) interest of the Union Oil Company of California in, to and under said lease, by virtue of a conveyance thereof from Union Oil Company of California to said Burnham Exploration Company, which instrument of conveyance was duly recorded on the 10th day of December, 1924, in Book 4241, Page 186, of the Official Records of Los Angeles County; and

Exhibit 22—(Continued)

Whereas the Union Oil Company of California and Burnham Exploration Company and Shell Oil Company, the lessees under said lease, have requested from the Dominguez Estate Company certain modifications in the terms of said original lease, which the said Dominguez Estate Company is willing to grant for the time, in the manner and subject to the conditions and obligations next hereinafter set forth;

Now, Therefore, This Agreement made and entered into this day of August, 1936, by and between Dominguez Estate Company, as lessor, and Union Oil Company of California, Shell Oil Company and Burnham Exploration Company, as lessees,

Witnesseth:

That for and in consideration of Ten Dollars (\$10.00) to the Dominguez Estate Company in hand paid, receipt whereof is hereby acknowledged, and other valuable considerations to it moving, the parties agree as follows:

That Section IV of said lease, entitled "Twenty Year Term and Rights of Lessees Thereafter" which reads in part as follows, to-wit:

"The term of this lease shall be twenty years from and after the date hereof and for so long thereafter (but not exceeding twenty additional years) as oil, gas or other hydrocarbon substances shall be produced and saved from

Exhibit 22—(Continued)

said leased lands in commercially paying quantities.”

be modified, changed and an extension effected so that hereafter the same shall be as follows:

The term of said original lease is hereby extended so that the same shall continue to and terminate at 12 o'clock midnight of August 30, 1963.

At the expiration of said forty-year drilling period, to-wit, August 30, 1963, all unbilled lands shall be free from the terms and conditions of said indenture; provided that the Lessees shall have full right to retain, operate, redrill, clean out, deepen, repair, pump and work all oil wells or gas wells or other wells or works existing upon said leased lands at the time of the expiration of said drilling period, so long thereafter (but terminating August 20th, 1973 at midnight) as oil, gas or other hydrocarbon substances shall be produced and saved from said wells or works respectively in commercially paying quantities, upon the rent and royalty and subject to the terms and conditions in said lease specified; and the Lessees shall have and retain with each well, so long as it shall be so retained and operated, a parcel of land around each well of such size, not exceeding five (5) acres, as it may reasonably deem necessary, and so long as any well or wells shall be so retained

and operated the Lessees shall have and retain all reasonable rights-of-way for ingress and egress to and from said well or wells and full rights-of-way for its water lines, gas lines, oil lines and other pipe lines, and telegraph, light, power and telephone lines, and all other means of access, and all works and improvements useful for the operation of each of said wells and the production, storing and/or transporting of the product thereof upon the leased lands.

That subdivision (B) entitled "Frurther Drilling Requirements," subdivision (D) entitled "Additional Wells," and subdivision (E) entitled "Offset Wells" of section Numbered V, entitled "Drilling Operations of Lessee" of said lease be and the same are hereby amended to read as follows:

(B) The lessees covenant and agree that they will, beginning August 31, 1936, maintain and keep diligently and continuously working (except for excusable delays specified in clause (G) hereof) one string of tools in the drilling or deepening of wells, into the formation below the Pliocene, allowing Thirty (30) days between the completion and testing of a well and the commencement of another well.

The lessees further expressly covenant and agree that in the event that any well or wells which shall produce oil in commercially paying quantities from formations below the Pliocene, are drilled on what are known as the Wright and Callendar, I. W. Hell-

Exhibit 22—(Continued)

man and Childs lands, or any of them, lying immediately to the north of the lands included in said original lease, or on any other land adjoining said demised property, then the lessees herein will likewise drill such well or wells or deepen such existing well or wells on the lands included in the original lease into the same producing zone or zones as the well or wells on said adjoining lands, as may be required to fairly protect said demised lands from drainage, and shall operate such number of strings of tools as may be necessary at any time to comply with this provision.

(D) During the aforesaid 40-year drilling period the Lessee may drill as many additional wells as it chooses and may redrill, deepen, repair and clean any and all wells drilled on said property.

(E) In case at any time after the date of this lease, and during the 40-year drilling period, but no longer, any well shall have been drilled upon lands in the vicinity of the leased premises and within three hundred (300) feet of any boundary line of said leased lands, and shall, when put on the pump or permitted to flow, have produced at least one hundred (100) barrels of oil per day during a thirty-day test, then the Lessee shall, within ninety (90) days after the expiration of said test, commence drilling operations for an offset well upon the leased lands (unless a well has been already drilled on the leased lands which is so located as to amount to an offset well as herein provided). Any

Exhibit 22—(Continued)

such offset well shall be located within three hundred (300) feet of the boundary line of the leased lands and within three hundred feet (300) of a line drawn at right angles from the well to be offset to the boundary line of said leased lands. said offsetting requirements are, however, subject to the following conditions, namely:

First: One well, if otherwise meeting the conditions of this subsection head "Offset Wells", may constitute an offset to two or more wells.

Second: Any such offset well shall count upon the number of wells specified to satisfy the drilling requirements set forth in subsection (B) hereof entitled "Requirements after Discovery."

Third: The Lessee shall not be required to drill a well to offset any well drilled on adjoining lands at the time owned by the Owner.

Any offset well which the Lessee is required to commence, as aforesaid, shall be drilled and completed with reasonable diligence in the same manner as is required for other wells as set forth in this indenture.

Subdivisions (C), (F), (G), (H) and (I) of said Section V shall continue in full force and effect.

That Section XIV entitled "Forfeiture" be, and the same is, hereby amended to read as follows:

In case Lessees shall be in default in the performance of any covenant or agreement by them to be

Exhibit 22—(Continued)

done or performed under this lease, then this lease shall, after thirty 30 days' written notice of the existence of the default given by the Owner to the Lessees and upon failure of the Lessees to correct within said thirty (30) days, or to commence within said thirty (30) days, in good faith and continue with reasonable diligence until the default be corrected, appropriate work and efforts for the correcting of their default, terminate and become null and void at the option of the Owner, except as to the reserve rights of the Lessees as hereinafter specified; and the Owner in such event may take possession of said leased lands free and clear of this lease, subject to the rights of the Lessees as hereinafter specified, and Lessees shall promptly vacate and surrender said leased lands to the Owner and execute and deliver to Owner a quitclaim deed releasing all their rights, title and interest in said leased lands, reserving, however, to the Lessees the rights hereinafter specified and also including the right to remove therefrom their property as specified in Section XV hereof. But in the event of any such forfeiture Lessees shall have the right (subject to the terms of this lease as to royalties and other matters) to retain any well or wells theretofore completed or on which work is being done in good faith at the time of such forfeiture, with full right to retain, operate, redrill, clean out, deepen, repair, pump and work the same, so long as any such well or wells shall continue to produce oil and/or gas in the quantities specified as com-

Exhibit 22—(Continued)

mercially paying in Section IV hereof entitled "Forty Year Drilling Term and Rights of Lessees Thereafter"; together with a parcel of land two hundred (200) feet square with the well in the center thereof around each such well; together with such rights of access, rights-of-way to and from such well or wells for repair, maintenance and operations, and all necessary roads, pipe lines, telephone, power and light lines as may be necessary in the operation of said wells, and/or in producting, saving, collecting, and/or transporting the oil, gas and/or hydrocarbon substances produced from such well or wells; and further provided that the Owner, after re-entering, shall not drill or excavate for oil, gas or other hydrocarbon substances at any place on the leased lands nearer than three hundred (300) feet of any well so retained by Lessees while such well shall produce oil or gas in the quantites aforesaid.

Provided, however, should lessees become in default on account of non-compliance with the provisions of Subdivision B of Section V entitled "Drilling Operations of Lessees" as herein contained, no forfeiture may be declared or had of lessees' drilling, producing and other rights under and as provided in said lease (as hereby modified) in and with respect to the Pliocene formations and formations above the same. In the event a forfeiture be declared and effected by reason of the non-compliance by the lessees with the provisions of Subdivision B. of Section V, the same shall apply only to formations below the Pliocene, and the

Exhibit 22—(Continued)

lessor herein, its agents and/or lessees, shall have the right to enter upon said demised premises for the purpose of drilling such number of wells as it may desire into the formations below the Pliocene and to produce oil and gas and other hydrocarbon substances therefrom, with all necessary rights of way, and rights to use the surface of the premises for any and all purposes in connection with the drilling, operation and maintenance of such wells and the production, storage, transportation and treatment of the oil, gas and other hydrocarbon substances which may be produced therefrom. Provided, however, that said rights shall be so exercised by the lessor, its agents and lessees, as not to interfere with the exercise by the lessees of the rights reserved and retained by them under said leases hereby modified, and provided further that the lessor may not drill any well at any place on the leased premises nearer than 300 feet of any retained well of the lessees which may be drilled and producing from the formations below the Pliocene while such retained well shall produce oil and gas in commercially paying quantities.

That section VIII, entitled "Rental and Royalties" be amended by adding thereto and making a part thereof, the following:

If for any calendar year beginning with the year 1937, the royalties accruing to the lessor hereunder shall have a value of less than the sum represented by the number of acres of land then retained by the Lessees hereunder multiplied by one hundred

Exhibit 22—(Continued)

twenty Dollars (\$120.00), then the Lessees shall, within sixty (60) days after the end of such calendar year pay to the Lessor as additional royalty such sum as, when added to the value of the royalties for the preceding calendar year, shall equal the sum so arrived at.

Furthermore, that that portion of said Section VIII which reads as follows:

“At the Owner’s option the Lessee will purchase said royalty oil from the Owner and shall pay the Owner therefor the market price for oil of like grade and gravity at the wells of production in the general vicinity, and if there be no such price, then the price to be paid shall be fixed by mutual agreement, and if the parties cannot agree, then the Owner shall take her royalty in kind. From time to time, whenever the Owner exercises her option with reference to the delivery of her royalty in kind, or to receiving payment therefor from the Lessee, as above provided, the Owner shall give to the Lessee in either case ninety (90) days’ written notice of her exercise of such option.”

be amended or changed to read as follows:

“At the Owner’s option the Lessee will purchase said royalty oil from the Owner and shall pay the Owner therefor the market price for oil of like grade and gravity at the wells of production in the Los Angeles Basin, and if

Exhibit 22—(Continued)

there be no such price, then the price to be paid shall be fixed by mutual agreement, and if the parties cannot agree, then the Owner shall take her royalty in kind. From time to time, whenever the Owner exercises her option with reference to the delivery of her royalty in kind, or to receiving payment therefor from the Lessee, as above provided, the Owner shall give to the Lessee in either case ninety (90) days' written notice of her exercise of such option."

It is understood and agreed that from and after the execution of this agreement no assignment or transfer may be made by any of the Lessees of any fractional part of its interests in said lease or in the premises covered thereby, nor may any sublease of any part of said demised premises be made without the Lessees first obtaining the consent of Lessor thereto in writing. Any such purported assignment or transfer or sublease so made in violation hereof shall be void and of no force or effect. Subject to the limitations hereinabove contained in this paragraph, this agreement shall be binding upon and inure to the benefit of the respective parties and their successors and assigns.

All other terms, provisions and conditions in said original lease contained are continued to the same effect as if this agreement of modification had not been entered into, and without limiting the generality of the above, all provisions for royalty, taxes,

Exhibit 22—(Continued)

default and forfeiture apply to this modification of said lease as the same are set forth in said original lease.

In Witness Whereof the parties hereto have executed this agreement this 25 day of August, 1936.

DOMINGUEZ ESTATE COMPANY,

By H. H. COTTON,
President,

WM. S. MARTIN,
Secretary.

UNION OIL COMPANY OF CALIFORNIA,

By W. W. ORCUTT,
President,

W. R. EDWARDS,
Secretary.

SHELL OIL COMPANY,

By S. RELITHER,
President,

B. O. KOONTZ,
Assistant Secretary.

RESPONDENT'S EXHIBIT AA

Prices Used in Estimation of Royalty Dollars
Dominguez Estate Co. Leases

	Price Per Ebl.
Reyes	\$1.23
De Francis	1.10
Manuel	1.07
Carpenter	1.10
Selbar	1.02
United Supply92
Standard-Getty66
Royal Petroleum63
C.C.M.O.65
Holly Development42
Hildden-Caminol	1.07
Wood-Callahan65
Pettijohn-Jergins65

Carson Estate Company Leases

Carpenter	\$1.10*
Hildden-Caminol	1.07
Union Carson	1.21
Standard Carson71

*Less \$150.00 yr. Rental to Childs Estate.

[Endorsed]: Filed Dec. 20, 1946.

RESPONDENT'S EXHIBIT BB

[Letterhead]

DOMINGUEZ ESTATE COMPANY

March 25, 1941

To the Stockholders of
Dominguez Estate Company:

In presenting herewith the Financial Report for the year 1940 you will observe that we have had a considerable reduction in income from that received in 1939. This reduction, as usual, has been caused by a decrease in the amount of oil royalties due to oil pro-ration reductions and price changes which have been called to your previous attention.

While it is true the drilling of new wells on the Reyes Lease has continued during the year, resulting in increased potentialities, it is still undetermined whether the zone below the eighth calendar zone in the field will be productive enough to warrant development. Up to date nothing in the field has shown anything worth while below the 9000 foot level, although wells have been drilled on adjoining property to a depth of 12,000 feet and on our own property below 10,000 feet, but no appreciable production was recovered. However, the leasing company still believes that there are some productive zones below those now known and producing.

Since the first of this year there has been some increase in the pro-ration allowances on the lease which, if continued, would result in some increase in income over the previous year, but it is prob-

EXHIBIT BB (Continued)

lematical how long these increases will continue and whether we shall be able to even maintain our production schedule of last year. There are also changes to lower values in the price structure in the last few weeks, the Standard having posted a cut of 10c a barrel on light gravity oils in the northern fields, but it has not yet affected the prices in the Los Angeles basin. We had some hopes that a bonus for our type of crude would be restored during the year but this has not yet developed; however, any chances we may have to sell this product at a better price than posted price will be taken advantage of immediately, as we are now operating under a thirty day schedule with the Union Oil Company in contrast to our previous six months period of election as to the sale of oil.

Last year I called your attention to Federal Bill known as the "Cole" Bill, which provided for federal regulation of oil production and which, if it became a law, would seriously affect our production. This Bill was defeated in Congress, but unhappily it is up again and I understand that it has the backing of both the Secretary of the Interior and the President, although it is far from being enacted into law as yet. All the California companies are making a decided effort to defeat the Bill before it is even brought onto the floor of Congress.

During the year we were successful in leasing a large portion of the west field of Torrance and ex-

EXHIBIT BB (Continued)

pect to have during this year some development which will give us additional production in this field. In addition the General Petroleum Lease, West Field, was cancelled and new operators have taken it over, who agree to operate and put into production all of the present wells in that lease and also to drill six new wells. This should result in an additional revenue not heretofore enjoyed by the company in this district. While there have been some new developments both to the north and west of the Hill field, there is nothing yet that would tend to show our productive acreage can be materially enlarged on Dominguez Hill.

During the year an attempt was made to develop oil production north of Torrance and adjoining Western Avenue, a district that had not previously been developed and where we had a large tract of land which the directors felt should be tested before sales of real estate were made. A well was drilled to 7172 feet; at 7130 feet the basement schist was encountered which showed that further development was useless. Very little showing was made in this well proving that the existence of oil or gas in production quantities in this district was not possible, and that the best policy would be to dispose of lands in this area for other purposes.

The Real Property tax situation, which I called to your attention in last year's letter, is one to which we are still devoting considerable time and energy and, while we were successful this year in

EXHIBIT BB (Continued)

reducing the assessed values \$370,530.00, which resulted in savings of taxes of approximately \$17,000.00, we still feel there is a chance for much larger and better adjustments on the unimproved acreage property.

During the year we have had little or no inquiry for land in our district for improvement or development but, with the coming of the Defense Program, we hope that something will develop in the near future which will allow us to dispose of some of our unproductive lands.

We have succeeded in making an arrangement with a builder and developer to start development on a 100 acre tract on Santa Fe and Garson Street, 20 acres of which will be immediately subdivided and developed, and reasonably priced homes built to sell at approximately \$3000.00. This should result in some appreciation of values in this immediate district in addition to giving increased revenue to our wholly owned subsidiary, the Dominguez Water Corporation.

The County Board of Supervisors and the Government Flood Control Departments have finally placed in the budget an item of \$1,900,000.00, which will be applicable in a large measure to the improvement and acquisition of lands in the Dominguez territory, and which at the same time would have a decided effect toward restoring to use some of our land, and clear up a situation that we have

EXHIBIT BB (Continued)

been fighting with for several years. This has not been finally completed, but we have every reason to believe that something will be done in connection with it during the coming year.

Our building rentals and rents are very satisfactory and, with very few exceptions, our properties are completely occupied at a very fair rate of return on the investment.

During the year it was necessary to replace the pumping equipment of our wholly owned subsidiary, Dominguez Water Corporation, as the State had condemned our steam plant on account of excessive age, and the cost of electric power had become excessive. We have made a new installation at a cost of approximately \$80,000.00, which we believe will result in a saving of not less than \$15,000.00 a year in our cost of power, thereby retiring the entire cost of installation within five years, and from then on give us a substantial profit instead of a loss in our operations. We believe that the stockholders will be very interested in seeing this installation as it is regarded as one of the finest in the country.

During the year our net profit was reduced from \$761,835.02 to \$582,222.21, a decrease of \$179,612.81, of which \$171,008.87 was occasioned by reduction in oil royalties. A comparison of the royalty oil production and royalty dollars received for the years 1939 and 1940 are as follows:

Exhibit BB—(Continued)

Year	Royalty Bbls.	Royalty Dollars
1939	589,244.09	\$674,074.94
1940	520,448.66	542,476.78
Decrease of 1940 over 1939.....	68,795.43	\$131,598.16
or a Net Reduction in Royalty Oil of.....		\$131,598.16
and a Reduction in Gas and Gasoline		
Royalties for 1940		39,410.71
or a total Reduction in Royalties for 1940 of		\$171,008.87

This difference is largely in the price structure occasioned by both a drop in price and the loss of our bonus sales, as you will see that while production was 68,795 barrels less our returns were \$171,000.00 less.

There is a reduction of \$16,537.81 in our real estate account, being the difference between additions amounting to \$14,822.29 and depreciation for year amounting to \$31,360.10 and, inasmuch as no appreciable sales were made this year, no profit to any extent was reflected. There was an increase in rentals amounting to \$9,485.65 due largely to rents received from building erected at 5459-61 Wilshire Boulevard in the amount of \$5,700.00; the balance of increase was from additional rentals in Dominguez Wilshire Building. Other income remained at approximately the same basis as in the past.

Notwithstanding the reduction in income, we paid during the year dividends in the sum of \$755,928.00, and in doing so depleted our Earned Surplus in

Exhibit BB—(Continued)

the sum of \$251,486.54. It still continues to be the policy of the directors to maintain the dividends at at the present rates as long as possible to do so, using our Earned Surplus to supplement any deficiency in the income, and to give to the stockholders all possible returns as long as we are able to do so and keep the company in a position of liquidity in line with good business principles. Unless something drastic happens to our situation in the oil production we believe we shall be able to do so for some years to come. However, with the unsettled conditions of world and national affairs, and the ever increasing tax rates, we can not predict very far into the future and can only work on a day to day basis to measure with conditions as they exist.

Respectfully submitted,

H. H. COTTON,
President.

March 24, 1941

H. H. Cotton, President
Dominguez Estate Company
Los Angeles, California

Dear Mr. Cotton:

I am handing you herewith Annual Report of the Dominguez Estate Company for the year 1940.

The Net Profit for the Year 1940 as recorded on the books amounted to	\$582,222.21
as compared to the Year 1939, which amounted to	761,835.02
or a Decrease of income amounting to.....	<hr/> \$179,612.81

Exhibit BB—(Continued)

This Decrease of income is arrived at as follows:

Income

Decrease in Royalties in Year

1940 over Year 1939..... \$171,008.87

Increase in other income in

Year 1940 over Year 1939.... 4,378.74

or a Net Decrease of income amounting to.. \$166,630.13

Expenses

Decrease of operating expenses for the Year

1940 over Year 1939 amounted to..... 12,738.15

or a Net Decrease of Operating Profit for

the Year 1940 over Year 1939 of..... \$153,891.98

Capital Losses Sustained in Year 1940

Cost of Drilling Dominguez

Fee No. 1 Well—Abandoned

—No Production \$ 32,343.68

Cost of Stock of Engineering,

Inc.—Written off—Worth-

less 10,000.00

Total Capital Losses in Year

1940 \$ 42,343.68

Deduct

Capital Loss in Year 1939—

Kaspere Cohn Note 16,622.85

Increase in Capital Losses in Year 1940

Over Year 1939 25,720.83

Making a Net Reduction in Income for the

Year 1940 over 1939 of..... \$179,612.81

Dividends amounting to \$72.00 per share, or \$755,928.00, were paid in the year 1940, and depletion of Oil Leases amounting to \$180,807.53 was used in computing the Federal Income Tax for the year, which amounted to \$82,075.02.

Exhibit BB—(Continued)

Investments

Bonds purchased during the Year amounted to		\$ 43,486.95
Less Bonds which were sold during the year, and which cost	\$ 13,574.45	
Liquidating Dividend on Municipal Bond Company's Bonds	1,800.00	15,374.45
		<hr/>
Making an Increase in Bond Account.....		\$ 28,112.50
Stocks Purchased during the Year amounted to		\$ 42,249.75

Less

Stocks which were sold during the Year \$320,295.00, costing \$321,896.90		
Capital Dividends on Park Wilshire Stock	3,029.17	
Curtis Publishing Company Stock Reorganization	14,851.00	
Engineering, Inc. Stock—written off	10,000.00	349,777.07
		<hr/>
Making a Decrease in Stock Account During Year 1940		\$307,527.32
and a Total Decrease in the Investment Account during 1940		\$279,414.82
which Subtracted from the Stock and Bond Investment Account as of January 1, 1940		2,303,492.35
		<hr/>
Makes a Total of Stock and Bond Investments as of December 31, 1940.....		\$2,024,077.53
Deducting Accrued Interest Purchased in Year 1939 and collected in 1940.....		44.44
		<hr/>
Makes a Grand Total of Investments December 31, 1940		\$2,024,033.09

Exhibit BB—(Continued)

Oil Development—Wilmington

The oil development on Block 19, Range 7, is reflected in the following figures:

Tangible Drillings Costs

	Casing	Derrick	Total
Well No. 1	\$ 6,968.87	\$2,826.10	\$ 9,794.97
Well No. 2	5,165.69	2,072.97	7,238.66
Totals	\$12,134.56	\$4,899.07	\$17,033.63
Field Equipment			7,454.63
Total Tangible Drilling Costs.....			\$24,488.26
Intangible Drilling Costs, consisting of Labor, Material, etc. drilling wells			12,453.25
Total Costs			\$36,941.51

Production from May 1937 to November 1940 inclusive amounted to 281,154.52 barrels, and 50% of this production, or 140,577.26 barrels, produced royalty of \$91,771.94. Operating expenses amounted to \$26,045.53, leaving a net royalty of \$65,726.41. Deducting drilling costs of \$36,941.51 from the net royalty of \$65,726.41 leaves a balance of \$28,784.90 over all costs for drilling and operating these wells for the period from May 1937 to November 1940 inclusive.

Had this venture been handled on a straight 1/6 royalty basis the result would have been as follows:

Total Production Barrels	281,154.52
1/6 Royalty Barrels	46,859.09
1/6 Royalty Dollars	30,590.65

The net amount received from operations for the

Exhibit BB—(Continued)

period May 1937 to November 1940 inclusive amounted to \$28,784.90, which was \$1,805.75 less than that which would have been received on a 1/6 royalty basis. However, the company has a 50% interest in well and field equipment costing \$73,-883.02, which is fully paid for.

Respectfully submitted,

FRED DREW,

Assistant Secretary.

[Endorsed]: Filed Dec. 20, 1946.

RESPONDENT'S EXHIBIT CC

[Letterhead]

DOMINGUEZ ESTATE COMPANY

March 28, 1940

To the Stockholders of
Dominguez Estate Company:

In presenting herewith the Financial Report for the year 1939 you will observe a considerable reduction in our income from that of 1938. This reduction is caused principally because of decrease in oil royalties, due entirely to the oil proration regulations which were put into effect and which were called to your attention in my report of March 30, 1939. I advised you at that time that we could look for a falling off in royalties for some time to come and until the industry became more stabilized. In

Exhibit CC—(Continued)

addition to this, there has been a cut in the price of crude oil posted by the Standard and Richfield Oil Companies. This cut, however, has not yet been recognized by the balance of the companies, but has resulted in a very unstable price structure in all gravities of crude oil. Further, we have not been able to maintain the previous bonuses received from the sale of our crude to independent operators. We believe this condition shows signs of clearing up and it may be possible in the near future that we will again be able to obtain a bonus over the posted price for our oil, but there are no indications that the immediate future holds any hopes for an appreciable increase in the proration production of the wells.

During the year a resolute endeavor was made by the Standard Oil Company and some of its affiliates to pass a state regulatory law on oil production, and it was only by the determined efforts of the Independents that this was defeated. Had this become a law our production would have been further materially reduced and, naturally, our income would have been reduced pro rata.

A Bill is now pending in Congress, commonly known as the "Cole" Bill, which provides for federal regulation of oil production and, should it become a law, will again seriously affect us. In Texas the large producing oil wells are only allowed from 25 to 30 barrels a day per well, even though these wells are capable of producing from 1000 to 5000

Exhibit CC—(Continued)

barrels per day. The same condition prevails in Oklahoma, although not to such a drastic extent. Therefore, if this Bill becomes a law, naturally all wells throughout the nation would be placed on an equal basis of production, and there is no telling what our situation would be.

In order to safeguard the interests of our company against the many regulations imposed upon us by different governmental agencies relating to oil production in these fields, we are obliged to devote a great deal of labor and attention to these matters, and we ask the stockholders for their united support and assistance in combating these elements which might eventually very seriously affect the income of all of the stockholders of the company.

As far as the potential production of the fields is concerned it has held up very evenly, and I believe that new reserves, not previously known that make for a long life and much greater potential production in the field, have been developed. Several new wells have been brought in on Dominguez Hill properties, some at depths not heretofore productive; however, in one of the wells drilled on the Hill, we again ran into an unproductive zone at 10,000 feet, showing that faults exist both north and south and east and west, and that it is unpredictable where the production lies until the property is drilled.

Exhibit CC—(Continued)

During the year the directors believed it advantageous to prove as much of the territory as possible, and agreed to drill a well, for experimental purposes, in the north Torrance field which, unfortunately, did not prove productive; although some slight showings were found, nothing was proved that would make your directors believe that any of this territory, west of Western Avenue and north of Torrance and adjoining the General Petroleum property on the east, is in a productive zone.

There have been some new developments to the north and west of the ranch that may prove some further production on the Hill, but this is very problematical at the present time. However, we will make every effort during the coming year to have this territory developed by any reputable companies that will agree to drill same.

We believe that efforts should be made to develop your property at the west end of the ranch, adjoining the city of Redondo, where small production of a lower gravity oil (at very low cost per barrel) has been successful over a twenty year period, and we are of the opinion that some development should be made on these lands.

Another problem on which we have been working, and one in which a great deal of progress has been made up to the present time, is the tax situation. We feel that considerably more effort will have to be expended, however, on this matter before ac-

Exhibit CC—(Continued)

completing the desired results. A large portion of the land is not suitable for agricultural purposes, and there is no demand for it for any other purpose, either residential or manufacturing, yet in a majority of cases the assessor has assessed this land on a basis of industrial or semi-industrial use, thereby making our tax rate exorbitant and the cost of carrying same a constant drain and expense to the company, without any hope of recompense or return by sales at increased values. The demand for property of this kind, which is only suitable for heavy industries such as steel plants, oil refineries, chemical plants, etc. (a type virtually excluded from other districts), is very restricted, and the sales for many years past and, probably many more to come, will be in very small parcels, yet our taxes are figured on practically the same basis as though the land were in actual use. Our idea is to have the land tested for its oil production possibilities as fast as possible and, if it is not commercial oil property, to make every effort to dispose of it, thereby eliminating any further drain on the resources of the company.

During the past several years we have been working with the County Board of Supervisors and Government Flood Control Departments on the sale or disposition of Nigger Slough to the Gardena Valley Flood Control for flood control and park purposes. This property has been condemned by government authorities as unfit for human habita-

Exhibit CC—(Continued)

tion on account of flood conditions; therefore, it is absolutely unsuitable for any other purpose and can never be disposed of on account of its zoning, except for governmental use. This may take some time but, in the meantime (while we still retain title) we have ceased to pay any further taxes on this land because we can always redeem it on a basis much less than its current taxes and, probably, we will not have to pay anything if it is taken over by any governmental agency.

During the year we completed a building on the westerly portion of the property at Wilshire Boulevard and Cochran Avenue, which is now fully occupied and leased at rentals showing very good returns on the investment. We are negotiating at the present time with a major tenant for the easterly portion of this property, which includes the corner, and, if successful, this will make one of our best income producing properties.

During the year we were able to close out the Ben R. Meyer account, which has been a source of great trouble and worry to the company. In settlement of his note we received the sum of \$100,000.00 in cash, occasioned by the sale of his home property, and an assignment of the furniture and fixtures in his home. We have been endeavoring to dispose of these furnishings and up to the present time have been successful in selling a large portion of them, hoping that it might be possible to realize approximately \$50,000.00 from the sale. This would result

Exhibit CC—(Continued)

in a further loss of \$25,000.00 in this very unsatisfactory account.

It was our misfortune during the year to lose our Director and Vice-President, Mr. Robert L. Watson, who had served the company long and faithfully, and your directors keenly feel the loss of his association. Upon the request of a majority of the stockholders of this company, Dr. J. R. Lacayo was elected as a director to serve the unexpired term of Mr. Watson.

During the year our net profit was reduced from \$1,205,010.54 to \$761,835.02, a decrease for the year of \$443,175.52, of which \$434,283.34 was occasioned by reduction in oil royalties. There is a \$33,000.00 difference in our real estate account, which showed a profit for 1938, but, inasmuch as no appreciable sales were made this year, no profit to any extent was reflected. There was a reduction in rentals of \$17,757.02, caused to a great extent by the amount of rental received from the Western Union property, their old lease having expired and a new one entered into at a reduced rental. In addition, there was also a loss on the rental of building at 833 South Spring Street, which is now in the process of litigation. Other income remained at approximately the same basis as in the past.

Notwithstanding this reduction in income we paid during the year dividends in the sum of \$755,928.00, and in so doing only depleted our Earned Surplus in the amount of approximately \$65,000.00. It will

Exhibit CC—(Continued)

be the policy of your directors to maintain the dividends at the present rates as long as it is possible to do so, using our Earned Surplus to supplement any deficiency in the income. We believe the policy of your company should be to give to the stockholders all possible returns as long as we are able to do so and keep the company in a position of liquidity in line with good business principles and, unless something drastic happens to the oil production as outlined above, we believe we will be able to do so.

In the unsettled condition of world and national affairs and, with the many problems that confront your company from day to day, we feel that the ability to pay a return of 7.7% on a basis of \$1000.00 per share on our stock is one thing that helps maintain the stability and value of this stock at somewhere near its appraised value.

Respectfully submitted,

H. H. COTTON,
President.

RESPONDENT'S EXHIBIT DD

[Letterhead]

Dominguez Estate Company

To the Stockholders of
Dominguez Estate Company:

In taking up the affairs of your company for the past year there have been many changes in

Exhibit DD—(Continued)

both the personnel of the stockholders and officers and directors, and the conduct of the business of the corporation has been changed to some extent.

I will not endeavor to go into all of the details of these changes as the most of them are familiar to the stockholders, but will call your attention to the conduct of the business during the past year, and recommendations as to its future conduct.

I will first take a short analysis of the balance sheet as of December 31, 1936, a copy of which is attached herewith.

The first item of consideration under Assets shows Cash in Bank of \$226,025.12. It has been the policy of this company to keep a very much larger amount of cash on hand, but your officers and directors feel that the cash can be better invested from a return standpoint, and that only a necessary amount of cash be kept on hand to care for the ordinary and extra-ordinary expenses that may arise to care for the conduct of the business.

The next item of Notes and Accounts Receivable in the sum of \$542,337.24 is made up in large part of the notes of Ben R. Meyer and Milton Getz; these notes have been reduced since the first of the year approximately \$60,000.00, and we feel will be further reduced this year.

The account show as Oil Royalties Due in the sum of \$89,915.81 has been paid since the time of this balance sheet.

Exhibit DD—(Continued)

The next item Investments shows Bond Account of \$217,352.01, which has been materially reduced from its figure of last year on account of the high price of bonds and the certainty that bond investments would decline in value, which decline has taken place since the time this statement was issued. The stock item in the sum of \$1,045,065.24, which is cost price on the books, reflects the majority of stocks which have been purchased within the last two years and shows an appreciation of market value at the time of this statement of approximately \$275,000.00 besides returning a reasonable rate of interest, and since January 18, 1937 have appreciated quite substantially in value.

The next item shown Assets Held in Trust rightfully belong in the real estate holding column, as a majority of the assets are unsold real estate now being held in trust.

The next item Due From Dominguez Water Company are bonds in the amount of \$500,000.00 and Open Account amounting to \$552.94, the Bond Issue being the money originally furnished by the Dominguez Estate Company for the construction of the Dominguez Water Company. Inasmuch as the Dominguez Estate Company owns the large majority of stock in the Dominguez Water Company and the larger holders outside of this company did not care to pay assessments to take care of the Bond Issue and interest and, in lieu thereof, have turned their stock in to the Dominguez Estate Company,

Exhibit DD—(Continued)

your officers and directors thought it for the best interest of the company to foreclose the bonds and take over the entire property and assets of the Dominguez Water Company, thereafter forming a new corporation and assigning to this new corporation all of the assets of the Dominguez Water Company and taking in exchange therefor the entire capital stock of the new company in payment for these assets taken under foreclosure proceedings by the Dominguez Estate Company. This will result in the Dominguez Estate Company having the complete ownership of the Dominguez Water Company without any outside stockholders. Necessary steps have been taken to accomplish this, and the transaction has been completed.

Our Unsold Real Estate values show as \$15,936,-294.83 consist of all the properties of the Dominguez Estate Company, both ranch lands and city properties. This item has been increased in the past year by the addition of approximately \$1,000,000.00 arising from the acquisition of the land and building of the Dominguez Wilshire Company, which company was dissolved and liquidated and the assets taken over by the Dominguez Estate Company.

In the Unsold Real Estate column you will notice two amounts, one "Land Value Increased by Appraisal"—\$4,499,381.93, which was an arbitrary value that was added on to the 1913 cost of \$3,-316,871.43, previously referred to, by an appraisal at the time the capital stock of the Dominguez Estate

Exhibit DD—(Continued)

Company was increased to take in the holdings of the Francis Land Company. This is an arbitrary figure and has no relation to true values. The same condition exists in the "Land Acquired in Exchange for Stock" item of \$7,277,230.53; this was an arbitrary appraisement of the lands and buildings acquired from Mrs. Francis, and also has no relation to the true values. The fact of the matter is that a true reflection of Dominguez Estate Company stock would be gained by reducing the Unsold Real Estate item at least \$6,000,000.00, which would bring the true values down to about \$10,000,000.00. Your directors during the next year will endeavor to make these changes in these items so as to bring the items to more nearly their intrinsic value.

The next item Valuation of Oil Rights in the amount of \$2,113,200.00 stands on the books at the depreciated value (on account of depletion taken) of \$39,444.04. I will not endeavor to set up any value in excess of this figure at this time, although the oil rights on the Hill are worth many times the value carried on the books, but inasmuch as the development of the lower stratas is now in process and we have uncovered a rather spotty condition as shown by two existing faults in the deep zones, we are unable at this time to give the stockholders any definite information as to the extent of the so-called lower or miocene formation on the Reyes lease.

The Manuel lease which has been non-productive for some years, with the recent work that has just

Exhibit DD—(Continued)

taken place, has shown ability to produce in the upper zones which were not originally exploited, and the Shell Company recently brought in a new well of approximately 200 barrels at a depth of 4258 feet.

We have been informed by the Shell Company that they are going to recondition some of the older wells on this lease and we can anticipate some further production. The Richfield lease to the south of it have assured us they will immediately begin exploration work on their property for further production in this newly discovered zone.

The other items on the balance sheet are of small amounts and do not need any further explanation. The one exception, however, is the Water Rights in the amount of \$80,800.00, which will be transferred to the new corporation that will handle the affairs of the Dominguez Water Company.

Supplementing the remarks in connection with the balance sheet of the Dominguez Estate Company, I would like to call to the attention of the stockholders the matters affecting the company that have taken place during the year.

During the year we purchased three pieces of real property, one being 472-480 East Colorado, Pasadena, a two-story brick building, in the sum of \$85,000.00. This property is paying a net return of eight per cent and is, we believe, worth at least \$115,000.00 at this time. We also purchased prop-

Exhibit DD—(Continued)

erty at the corner of 87th and Broadway for \$65,000.00, and improved the same with a one-story brick and concrete building, which we have leased to the Thrifty Drug Stores and J. J. Newberry Company, which property, we believe, will return a figure of nine to ten per cent per year on the cost. We believe that this property is worth \$25,000.00 or \$30,000.00 more at this time than the actual cost of the property. We also purchased the northwest corner of Cochran and Wilshire, being 130x180 feet, in the sum of \$162,500.00. This is the cheapest piece of property in the section known as the "Miracle Mile" and, in the opinion of the officers and directors, worth substantially more than we paid for the property. It is now rented to a gasoline station that pays about enough to take care of the taxes, but we hope to develop a major tenant for this property that will bring it into a very high income property.

During the early part of the year there was a controversy with the oil companies regarding the price of oil on the Hill, which had been materially reduced as against other fields, occasioned by overproduction of this field, which was forced by the Burnham Exploration Company and the Callender lease. We made arrangements not to sell at the posted price but to store the oil and finally obtained a settlement from the Shell and Union Oil Companies which returned to us a very substantial sum of money over the posted price. We have since

Exhibit DD—(Continued)

made arrangements to sell royalty oil on the Hill so it will net the company approximately \$60,000.00 a year in excess of the prices posted for like oil in Dominguez Oil Field.

According to an agreement previously made an extension was given to the Shell-Union Oil Companies for the drilling and developing of deeper zones on Dominguez Hill for a further period of twenty years. This agreement, before executing, was revamped several times, and we believe that the new agreement is a good thing for the company in allowing for orderly development.

Of the royalties received of \$1,143,124.03, \$946,234.90 or 83% is from crude oil royalties. Prior to this year only temporary and spasmodic verifications of the royalty receipts have been made. Beginning with August 1, 1936, a detailed distribution of every run ticket on production from the Dominguez Field is being made by the company's gauger, and price extensions and computations are being made in our office. The production covered in this way is approximately 99% of the total crude oil production. (About 17% comes from gasoline and gas, which to date is not being checked and verified in detail, but plans are also under way to check this production.)

In May 1936 the company arranged to reduce its stated capital to a sum not in excess of \$500,000.00 to create a surplus that could be used for the pur-

Exhibit DD—(Continued)

chase of stock from stockholders of the Dominguez Estate Company who wished to dispose of their holdings. Prior to this time the company was not in a position, on account of its capital structure, to do this and, inasmuch as it was a closed corporation, there was no way for anybody to dispose of their stock except at a tremendous sacrifice. Under the present conditions stock can be retained for members of the family and not get into outside hands by sales at depreciated values.

During the year the By-Laws were amended and adopted as of a meeting held on May 19, 1936. The old By-Laws had become antiquated and did not follow the California code, so that it was judged best that this action be taken.

In May 1936 an arrangement was made by which the Reys-Dominguez Company purchased stock of the O'Melveny family at a price of \$1,100,000.00, whereupon the O'Melvenys ceased to be stockholders or officers of the company. At the annual meeting held in May a new board and new officers were elected and have been conducting the affairs of your company ever since.

During the year the company sold several small pieces of property aggregating approximately \$50,000.00, and have collected quite a considerable sum of money in past due accounts.

We have felt it was the correct thing to change the dividend policy of the company and pay out

Exhibit DD—(Continued)

in dividends the earnings of the company in as near to their entirety as we could during the year, retaining only for surplus accretions the depletion allowance of the oil royalties. In line with this policy the company paid during the year 1936 \$61.50 per share in the form of dividends, and we believe that we will closely approximate this sum in the present year.

We have endeavored to vary the investment policy of the company to the extent of diversification of investment with reasonable interest rates and, as stated in the resume of the financial statement, have switched as much as possible from bonds to common stocks, on which the appreciation has been very considerable, and also investment in income producing real estate that show a good return on the investment and a very decided appreciation in value on the purchases.

Turning to the other side of the picture for a moment—we are confronted with a situation that is rather perplexing in its ramifications. The company carries in its assets many thousands of acres of unproductive ground which, unfortunately because of past sales and the exaggerated values placed thereon by tax assessors, is a severe drain on the earnings of the company in the shape of taxes and upkeep. We have been able to lease only a small percentage of the land at a figure that will even return taxes.

We are further confronted with a drainage prob-

Exhibit DD—(Continued)

tem in several portions of the ranch, one particularly in Dominguez Slough District, in which 600 or 700 acres of land of the Dominguez Estate Company are completely submerged by from one to six feet of water. Adequate drains cannot be installed to dispose of this water because of the minimum fall in feet to the ocean, and our application to the County Flood Control for relief was denied on the basis the land was not fit for human habitation. It seems that it should be the policy of this company to dispose of as rapidly as possible a large percentage of these unproductive lands both from the standpoint of Dominguez Estate Company as a corporation, but more from the point of the stockholders of this corporation because, as was exemplified in the Estate of Mrs. Francis, the values of the stock of this company are predicated on the value of the land as assessed by Government employees, and the value of the stock of Mrs. Francis was increased a tremendous extent by valuations that surely did not exist and many hundreds of thousands of dollars were paid in inheritance taxes.

These taxes, you realize, must be paid in cash, for the purpose of owning and holding this unproductive real estate, and this will become progressively worse in the estate of each stockholder of the Dominguez Estate Company, it being possible that all the liquid assets belonging to the stockholders will be used to pay inheritance taxes, and the remaining assets in the hands of the beneficiary

Exhibit DD—(Continued)

will consist of unsalable and unproductive lands with a heavy tax burden. This is a very serious situation and had not some of the lands of the Dominguez Estate Company been oil bearing and producing large sums of money, the Company would have been bankrupt by the necessity of having to carry these properties.

The year just closed has been the most profitable year the Dominguez Estate Company has ever experienced from operations alone, and it is possible that this year will be as good as last year, but we all must realize that the oil is gradually being depleted and we must look for diminishing returns from our oil properties and, although there is no question but what oil will be produced for many years on Dominguez properties, the peak of the production is certainly past and we can only look forward to diminishing returns. Therefore, we should endeavor to conserve and transfer our unproductive assets into productive assets that will enjoy a reasonable return or can be disposed of to advantage to the stockholders.

Respectfully submitted,

.....
President.

[Endorsed]: Filed Dec. 20, 1946.

Exhibit DD—(Continued)

Notice of Special Meeting of Shareholders of
Carson Estate Company

Notice Is Hereby Given that a special meeting of the shareholders of the Carson Estate Company, a California Corporation, will be held on Thursday, the 14th day of May, 1936, at the hour of ten o'clock a.m. at the principal office for the transaction of the business of said corporation, located at 815 L. A. Stock Exchange Office Building, 639 South Spring Street, in the City of Los Angeles, County of Los Angeles, State of California, for the purpose of transacting the following business:

To consider the advisability of entering into a voting trust agreement with the Watson Land Company, a California Corporation, for the voting of the stock owned by this corporation in the Francis Land Company, a corporation, consisting of 1785 shares and in which the said Watson Land Company is also the owner of 1785 shares.

Dated: This 6th day of May, 1936.

W. W. POWELL,
President of the
Carson Estate Company.

[Endorsed]: Filed Dec. 20, 1946.

RESPONDENT'S EXHIBIT JJ

Carson Estate Company

Minutes May 6, 1936

On motion duly made by David V. Carson, seconded by H. H. Cotton and duly carried, the following resolution was adopted:

Whereas, this Corporation is the owner of 1785 shares of the Capital Stock of the Francis Land Company, a corporation; and

Whereas, the Watson Land Company, a corporation is the owner of 1785 Shares of the Capital Stock of the said Francis Land Company; and

Whereas, the directors of this corporation consider and believe that it is for the best interests of this corporation and its stockholders that a voting trust agreement be made and entered into by this corporation with the Watson Land Company, a corporation, for the voting and control of the stock owned by this corporation in the said Francis Land Company.

Now Therefore Be It Resolved, that this corporation enter into a voting trust agreement in writing with the Watson Land Company, a corporation, the purpose of which shall be voting and the control of the stock owned by this corporation and by the Watson Land Company, in the Francis Land Company, a corporation, which said voting trust agreement shall be for the period of ten years from and after the date of the execution of the same, and

Exhibit JJ—(Continued)

in which said agreement five trustees shall be appointed to vote said stock, two of which said trustees shall be appointed from, and shall always consist of, two member of the Board of Directors of this corporation, and also two of which shall be appointed from, and always consist of, two members of the Board of Directors of the Watson Land Company, and the fifth trustee shall be appointed and controlled by the Title Insurance and Trust Company of Los Angeles as a disinterested party; and

Be It Further Resolved, that the President and/or Vice President and Secretary of this corporation be and they are hereby authorized and empowered to make and execute said proposed voting trust agreement for and on behalf of this corporation and said officers are authorized and empowered to provide such other necessary provisions in said voting trust agreement as they shall deem best for the interests of this corporation and its stockholders; and

Be It Further Resolved, that said above mentioned officers of this corporation be and they are hereby authorized to prepare and cause to be filed with the Commissioner of Corporations of the State of California, an application for permission to issue participating or voting trust certificates as may be provided for in said voting trust agreement and to execute any and all necessary documents in connection herewith.

Motion carried.

Exhibit JJ—(Continued)

On motion duly made by David V. Carson, seconded by Lucy C. Rasmussen and duly carried, the following resolution was adopted:

Resolved, that the two Trustees to be appointed by the Carson Estate Company to act for it under the aforesaid voting trust agreement, shall be H. H. Cotton and Edward A. Carson.

Directors voting Yes were Lucy C. Rasmussen, George E. Carson, David V. Carson, W. W. Powell, H. H. Cotton and Edward A. Carson.

Director voting No was Thomas P. Cooper.

On motion duly made by Edward A. Carson, seconded by W. W. Powell and duly carried, the following resolution was adopted:

Resolved, that a special meeting of stockholders of this corporation be called to be held on the 14th day of May, 1936, at 10:00 a.m. and that the proper notices be mailed immediately.

There being no further business the meeting thereupon adjourned.

RESPONDENT'S EXHIBIT KK

Voting Trust Agreement Relative to Capital Stock
of the Francisco Land Company, a California
Corporation

This Agreement, made and entered into this 15th day of May, 1936, by and between the Carson Estate Company, a California corporation, and the Watson

Exhibit KK—(Continued)

Land Company, a California corporation, as Parties of the First Part, (hereinafter sometimes referred to as the "Stockholders"), and H. H. Cotton, Edward Carson, Wm. S. Martin, Alphonse L. Watson, and Charles I. Baker, as Parties of the Second Part, (hereinafter called "Trustees"),

Witnesseth:

Whereas, the said above mentioned Carson Estate Company is the owner of 1,785 shares of the capital stock of the Francis Land Company, a corporation, and

Whereas, the said Watson Land Company, a corporation, is also the owner of 1,785 shares of the capital stock of the said Francis Land Company, and

Whereas, the said above mentioned corporations, as Parties of the First Part, believe it to be essential to their interests and further believe that their object as such Stockholders, can be best accomplished by acting together, and further believing that it is for the best interest of the said Francis Land Company that the said shares of stock herein transferred in the manner hereinafter provided shall be voted so as to secure a definite and fixed policy in the management and operation of the said Francis Land Company, including its earning capacity, the agreement of each constituting one of the considerations for the agreement of the others, and particularly by giving to the said Trustees as their agents

Exhibit KK—(Continued)

and attorneys-in-fact an irrevokable power to vote said shares of stock of the Francis Land Company upon the terms and conditions hereinafter set forth, and

Whereas, in order to accomplish said purposes and for their said protection the Stockholders have requested the said Trustees to take and hold for the period hereinafter stated the legal title of said shares of stock, the same to be held by them upon an active trust and to act under the terms of this agreement, and the trustees have agreed so to do.

Now Therefore, in consideration of the Mutual Agreements and Covenants, the said Stockholders do agree to and with each other and with the said Trustees, and the Trustees do agree with the Stockholders as follows:

1. All of the shares of stock of the said Francis Land Company now owned or controlled by the said Stockholders, being 1,785 shares owned by the said Carson Estate Company, and 1,785 shares owned by the said Watson Land Company, amounting in the aggregate to 3,570 shares, shall upon the signing of this agreement be endorsed and transferred to the said Trustees, to be held by said Trustees, for a period of ten (10) years from and after the date of the execution of this agreement, in trust, however, for the said Stockholders, their successors and assigns, for the uses and purposes of this trust and shall at all times be subject to the terms and conditions herein set forth.

Exhibit KK—(Continued)

The Parties of the First Part, as such Stockholders, do by these presents transfer and assign and convey to the said Trustees all of their and each of their right, title and interest in and to any of the shares of the capital stock of the said Francis Land Company now owned by them, and further agree that any and all certificates for additional shares of the stock of the said Francis Land Company that shall hereafter during the said period of ten (10) years be issued to either of the said Stockholders shall be in like manner endorsed and delivered to said Trustees to be held by them under the terms hereof:

2. Upon the transfer and delivery to the Trustees of the stock certificates for said shares the Trustees will then cause said certificates to be transferred upon the books of the Francis Land Company and new certificates therefor to be issued to the said Trustees, and thereupon the said Trustees will cause to be issued to each of the said Stockholders a trust certificate for the number of shares of stock represented by the respective certificate or certificates transferred to the Trustees hereunder, and that said trust certificates shall be in substantially the following form, to-wit:

“No..... Shares

Francis Land Company

Trust Certificate

This Certifies that has
deposited shares of the capital stock

Exhibit KK—(Continued)

of the Francis Land Company, a corporation, of the par value of \$100.00 each with the undersigned Trustees under an agreement between the Carson Estate Company, a corporation, and the Watson Land Company, a corporation, as Stockholders, of said Company, and

.....,

 and....., as Trustees, bearing date of the day of, 1936, the terms of which are incorporated herein by reference, and the holder of this Certificate takes the same subject to all the terms and conditions of the aforesaid agreement.

This Certificate and the interest represented thereby is transferable only on the books of the said Trustees upon the presentation and surrender thereof, properly endorsed. The Trustees may require as a condition for the transfer hereof the payment of a sum sufficient to pay or reimburse the Trustees for any transfer tax or any other governmental charge in connection with said transfer.

In Witness Whereof, the undersigned Trustees have executed this Certificate this day of.....19...

.....

Trustees.

Exhibit KK—(Continued)

3. During all of said period of ten (10) years said Trustees, or a proxy appointed by them, shall possess and be entitled to exercise the sole and exclusive right to vote all of said shares of stock of the said Francis Land Company standing in the name of said Trustees at all regular and special meetings of the shareholders of said corporation and may vote for, do, or assent or consent to, any act or proceeding which the share holders of said Company might or could vote for, do, or assent or consent to, and shall have all the powers, rights and privileges of a shareholder of said Francis Land Company. Also, to receive dividends, to exercise any preemptive rights and to have every and all of the benefits and rights accruing by virtue of the said shares of stock in the said Francis Land Company.

Provided, however, said Trustees shall not have the power to vote without first having obtained the consent of each of the Stockholders in writing, in favor of or against, or to execute consents with respect to the following:

(a) The increase of the authorized capital stock of the said Francis Land Company, the reclassification of its stock, or the issuance of any other class or classes of stock;

(b) The merger or consolidation of the said Francis Land Company with any other corporation;

Exhibit KK—(Continued)

(c) The dissolution of the said Francis Land Company.

4. In voting said shares said Trustees shall at all times exercise their best judgment and discretion to the end that the affairs of said Francis Land Company shall be carefully and intelligently managed and so that suitable directors shall be selected; the Trustees, however, assume no responsibilities and shall not be liable for any act or default of their part or on the part of any of the agents or employees, excepting only for negligence or bad faith.

5. The trustees shall not be entitled to receive compensation for their services but they shall be entitled to be paid and indemnified against any and all expenses and liabilities incurred by them in connection with or growing out of the discharge of their duties hereunder in good faith, including counsel fees, if they believe it necessary to employ counsel in carrying out the terms of this agreement, and the trustees shall have a first lien on all shares of stock and any income received by them and the proceeds thereof for repayment to them of their expenses and disbursements so paid out.

6. During the period of ten (10) years that this trust shall be in effect the trust hereby created shall not be revoked and the powers hereby delegated to said trustees shall be irrevocable except by consent in writing executed by each of the stockholders herein. This trust, however, shall terminate upon the expiration of the said ten year period. Provided,

Exhibit KK—(Continued)

further, however, that this trust shall in no event terminate until all fees of and claims against said Trustees hereunder have been fully paid and satisfied, or indemnified by the Stockholders against any and all liabilities arising out of this agreement; and that upon the termination of said trust the Certificate representing all of the shares so held under this agreement and then remaining in the hands of said Trustees or their successors shall be assigned to the parties then entitled thereto upon surrender to the Trustees or said Trustees' certificates representing said shares.

7. The Trustees are authorized to receive all cash dividends from the Francis Land Company upon the shares enumerated in said certificate and also in the event that the said Francis Land Company shall declare and pay any dividends in capital stock the Trustees are authorized and empowered to receive the same, and upon receipt by the Trustees the respective holders of such certificates issued hereunder shall be entitled to receive trust certificates to the amount of stock received by said Trustees as such dividends upon the number of such shares represented by their respective trust certificates theretofore outstanding. Any cash dividends shall be promptly paid over to the said certificate holders.

8. It is understood and agreed that two (2) of the above mentioned Trustees have been designated and appointed as such by the said Carson Estate Company from their Board of Directors, and that

Exhibit KK—(Continued)

two (2) of said Trustees above mentioned have been appointed by the Watson Land Company from their Board of Directors, and that the fifth member of said Trustees has been designated and appointed by the Title Insurance and Trust Company of Los Angeles, as a disinterested party. And it is further agreed that two of said Trustees shall always be appointed from and shall always consist of two members of the Board of Directors of the said Carson Estate Company, and likewise two of said Trustees shall be appointed and shall always consist of two members of the Board of Directors of the Watson Land Company, and further, that the fifth Trustee shall always be appointed and designated by the Title Insurance and Trust Company of Los Angeles, as a disinterested party. And it is further agreed in the event of a death, resignation or removal of said Trustees or either of them their successors shall be appointed and designated in the manner hereinabove specified, and any such successor shall be designated as such in writing and the appointment thereof delivered to the said Francis Land Company.

The said Trustees shall act by and through a majority of their number and any trustee authorized in writing by a majority of the Trustees may vote in person or by proxy the stock held in trust hereunder, or may execute any consents with respect thereto. The said Trustees are also empowered to adopt their own rules of procedure in respect to the administration of this trust. That at all of the meetings of the Trustees three (3) shall constitute a

Exhibit KK—(Continued)

quorum for the transaction of business. No Trustee appointed hereunder shall by reason of that fact be disqualified to be an officer or director of the said Francis Land Company or to hold any other position with the said Company.

9. That a copy of this trust indenture shall be filed at the office of the said Francis Land Company, and that a copy thereof shall be on file at the office of the said Trustees.

10. If any section, sub-section, sentence, clause or phrase of this agreement is for any reason held to be illegal or inoperative the same shall not affect the validity of the remaining portions of this agreement, unless the illegal or inoperative provision shall be of the essence of this agreement.

11. All of the agreements, stipulations and conditions herein contained shall apply to and bind all of the parties hereto and their successors and assigns.

12. The signing of this agreement by the Trustees shall constitute their acceptance thereof.

In Witness Whereof, the said Carson Estate Company and the said Watson Land Company have caused their corporate names to be subscribed and their seals affixed by their respective presidents and secretaries thereunto duly authorized by resolution

Exhibit KK—(Continued)

of their respective Boards of Directors this 15th day of May, 1936.

(Corporate Seal)

CARSON ESTATE COMPANY,

By /s/ W. W. POWELL,
President.

By /s/ H. H. COTTON,
Secretary.

WATSON LAND COMPANY,

By /s/ R. L. WATSON,
Vice President.

By /s/ H. H. JARRETT,
Secretary.
Stockholders.

/s/ EDWARD CARSON,

/s/ ALPHONSE L. WATSON,

/s/ H. H. COTTON,

/s/ WM. S. MARTIN,

/s/ CHARLES I. BAKER,
Trustees.

[Endorsed]: Filed Dec. 20, 1946.

RESPONDENT'S EXHIBIT LL

Reyes-Dominguez Company Minutes December 12,
1935

The president reported that the inventory of the Executor of the Estate of Maria de Los Reyer D. de Francis includes five (5) shares of Reyes-Dominguez Company stock carried at \$5427.40, and five (5) shares of Francis Land Company stock carried at \$4421.45, and he thought it advisable that the Reyes-Dominguez Company purchase these stocks from the Executor.

Upon motion duly made, seconded and unanimously carried, the following resolution was adopted, to-wit:

Resolved that the Reyes-Dominguez Company will make an offer to the Executor of the Estate of Maria de Los Reyes D. de Francis, deceased, to purchase from the said Executor the following discribed assets of said Estate, to-wit:

First: Five (5) shares of the Capital Stock of the Reyes-Dominguez Company for a total sum of \$5427.40.

Second: Five shares of the Capital Stock of the Francis Land Company for a total sum of \$4421.45.

Resolved further than upon a confirmation of the sale by the Superior Court of the State of California, in and for the County of Los Angeles, of each and all of said securities to Reyes-Dominguez Company, the officers of this corporation be and hereby are

Exhibit LL—(Continued)

authorized to sign a check in payment of the purchase price of said securities and to accept delivery of the said securities so purchased.

Minutes April 9, 1936

The president stated that it might be necessary for the Reyes-Dominguez Company to purchase 1100 shares of Dominguez Estate Company Stock from the O'Melveny family, and asked that a resolution be adopted authorizing the officers to make the purchase.

After discussion, upon motion duly made, seconded and unanimously carried, the following resolution was adopted, to-wit:

Resolved that the officers of this Corporation be and they are hereby authorized to purchase 1100 Shares of Dominguez Estate Company stock from the O'Melveny family at a price of \$1000.00 per share, same to be paid for in cash or bonds at the prevailing market value at the time of purchase.

Resolved further that prior to the time of purchase of said stock the act of the officers in consummating this purchase be ratified and confirmed in a document signed by the stockholders and filed with the Company to be recorded in the minutes.

Minutes May 13, 1936

The president also stated that it would be necessary for the company to agree to purchase 1100 shares of the Capital Stock of the Dominguez Estate

Exhibit LL—(Continued)

Company from the O'Melvenys for the sum of \$1,100,000.00, payable in cash and/or bonds, at the discretion of the officers of the Reyes-Dominguez Company, the value of the bonds to be appraised both by the O'Melvenys and Reyes-Dominguez Company.

The president also stated that in order to carry out the terms of the agreement that this corporation purchase from the Title Insurance and Trust Company, as Executor of the Estate of Maria de Los Reyes D. de Francis, deceased, 365 shares of the capital stock of the Francis Land Company at a price of \$1,000.00 per share, payable in cash upon delivery and transfer of said stock.

Be It Resolved, that this corporation purchase 1100 Shares of the Capital Stock of the Dominguez Estate Company, a California corporation, from the O'Melvenys, who are parties to the first part to said agreement, for the sum of \$1,100,000.00, payable either in cash or in bonds to be approved by this corporation through its president, H. H. Cotton, and the said O'Melvenys. Payment to be made upon delivery and transfer of said 1100 shares of stock to this corporation.

Be It Further Resolved that in order to carry out the terms and provisions of said agreement of May 8th, 1936, above mentioned, that this corporation purchase from Title Insurance and Trust Company of Los Angeles, as Executor of the will of Maria de Los Reyes D. de Francis, deceased, 365

Exhibit LL—(Continued)

shares of the Francis Land Company, a California corporation, at the price of \$1,000.00 per share, payable in cash upon the delivery and transfer of stock to this corporation.

Minutes September 11, 1936

11. As and when that shall appear to the directors to be the best interests of the shareholders in effecting such liquidation, bonds whether or not in default and likewise corporate shares (other than those of Francis Land Company and Dominguez Estate Company) may be sold at not less than the then current market value thereof instead of being distributed in kind; and in such case the proceeds thereof shall be distributed in lieu of and at the time when the property so sold would otherwise have been distributed, subject always to the requirement that such liquidation and distribution shall at all events be completed by September 11, 1938.

RESPONDENT'S EXHIBIT MM-1

Dominguez Estate Company Minutes April 10, 1935

The matter of a loan to Victoria Limacher of \$100.00 per month for not exceeding two years was brought up for discussion. It appearing that her present loan, both principal and interest, amounted to approximately \$11,000 and the security therefor was only five shares of the capital stock of Dominguez Estate Company, it was moved, seconded and

Exhibit MM-1—(Continued)

carried that her application for said loan should be granted on condition that she pledge not less than five additional shares of Dominguez Estate Company stock as security.

Minutes June 19, 1935

A discussion was had relative to certain shares of the Carson Estate Company owned by the former firm of Hunsaker & Britt and it appearing that the Carson Estate Company was not in a position to purchase said stock and it was believed ill advised to permit any of its stock to be held by persons outside of the present stockholders of the family corporations and that the stock was worth from \$400.00 to \$600.00 per share, it was thereupon moved, seconded and unanimously carried that this corporation would purchase said stock and pay therefor the sum of \$2000.00 and that the officers of this corporation were authorized to draw a check in payment therefor upon receipt of said stock duly endorsed.

Minutes May 7, 1936

Whereas this corporation has heretofore duly initiated proceedings for the reduction of its stated capital from \$1,049,900.00 to \$524,950.00;

Now Therefore, Be It Resolved that upon the completion of said proceedings and the creation of a reduction surplus of \$524,950.00, this corporation shall purchase not exceeding four hundred ninety-nine (499) shares of its outstanding capital stock,

Exhibit MM-1—(Continued)

at and for the price of one thousand dollars (\$1000.00) per share, and from ; and

Resolved Further that the officers of this corporation be and they hereby are authorized and directed to procure the authorization of such purchase of shares by the vote or written consent of the holders of at least two-thirds of the outstanding shares of this corporation, other than said 499 shares to be purchased; and

Resolved Further that upon the purchase of said 499 shares, the reduction surplus of this corporation shall be reduced by the amount of the purchase price of such shares, and such shares shall be restored to the status of authorized but unissued shares.

The said resolution was fully discussed by the directors present and after due consideration its adoption was moved, seconded and duly carried, upon roll call the following directors voting in favor thereof: H. H. Cotton, H. H. Jarrett, E. A. Carson and R. L. Watson, constituting four of the six directors, John O'Melveny not being present and H. W. O'Melveny not voting.

Minutes May 13, 1936

The chairman stated that at the special meeting of the Board of Directors held May 7, 1936, a resolution was adopted calling for the reduction of the stated capital of the company, the creation of a reduction surplus, and the purchase of not to exceed 499 shares of its outstanding capital stock; that he

Exhibit MM-1—(Continued)

was of the opinion that this resolution was prematurely adopted, and suggested that the resolution as adopted be rescinded and annulled.

The matter was fully discussed and, thereupon, the following resolution was offered, its adoption duly seconded and upon being put to vote was unanimously carried, to-wit:

Whereas, at a meeting of the board of directors of this corporation held May 7, 1936, resolutions were adopted authorizing the purchase of 499 of the outstanding shares of this corporation from unnamed persons; and

Whereas, it now appears that said resolutions were prematurely adopted;

Now, Therefore, Be It Resolved, that said resolutions authorizing the purchase of said shares of this corporation, as adopted at said meeting of the board of directors of this corporation held May 7, 1936, be and the same hereby are rescinded and annulled.

Whereas, the directors of this corporation are considering the advisability of taking appropriate proceedings to reduce the stated capital of this corporation, and to amend its Articles of Incorporation to reduce the par value of its outstanding shares from \$100 to \$50 each, and to authorize the purchase of certain shares of this corporation from the reduction surplus so created;

Now, Therefore, Be It Resolved, that a special meeting of the stockholders of this corporation be

Exhibit MM-1—(Continued)

and the same hereby is called to be held on May 25, 1936, at 3:30 o'clock p. m., at the office of this corporation in Room 824 Title Insurance Building, 433 South Spring Street, Los Angeles, California, for the purpose of considering and acting upon the following propositions:

(A) The reduction of the stated capital of this corporation from \$1,049,900 to \$524,950;

(B) The amendment of the Articles of Incorporation of this corporation to reduce the par value of its shares from \$100 each to \$50 each; and

(C) The purchase of not to exceed 499 shares of this corporation, at prices not exceeding \$1000 per share, out of the reduction surplus so to be created;

and

Resolved Further, that the secretary of this corporation be and he is hereby authorized and directed to mail to each of the stockholders of record of this corporation, on or before May 15, 1936, a notice of said special meeting of stockholders in substantially the following form:

Exhibit MM-1—(Continued)

“Notice of Special Meeting of Stockholders
of Dominguez Estate Company

To the Stockholders of
Dominguez Estate Company:

You are hereby notified that the Board of Directors has called a special meeting of stockholders to be held on May 25, 1936, at 3:30 o'clock p. m., in Room 824, Title Insurance Building, 433 South Spring Street, Los Angeles, California, for the purpose of considering and acting upon the following propositions:

(A) The reduction of the stated capital of this corporation from \$1,049,900 to \$524,950;

(B) The amendment of the articles of incorporation of this corporation to reduce the par value of its shares from \$100 each to \$50 each; and

(C) The purchase of not to exceed 499 shares of this corporation, at prices not exceeding \$1000 per share, out of the reduction surplus so to be created;

and for the purpose of transacting such other business as may come before said meeting.

Dated May 15, 1936.

FRED H. DREW,
Secretary of Dominguez
Estate Company.”

Exhibit MM-1—(Continued)

Minutes May 25, 1936

The President then stated that he deemed it to be to the best interests of the corporation to institute proceedings to reduce its stated capital from \$1,049,900.00 to \$524,950.00. He further suggested that the outstanding par value shares of this corporation be adjusted to the stated capital by changing the par value of said shares from \$100.00 each to \$50.00 each. By this procedure there would be created a reduction surplus out of which the company could purchase its own stock to the amount of such reduction surplus from any stockholders desiring to sell their stock, providing the holders of at least two-thirds of the remaining stock consent to such purchase.

Civil Code, and in general to do any and all things necessary to effect said amendment in accordance with said Section 362b.

The President stated that some of the stockholders had indicated a desire to sell a portion of their stock in the Dominguez Estate Company. He stated that as the company was initiating proceedings to place the company in a position to purchase stock from the stockholders, a motion was in order authorizing the purchase of stock out of reduction surplus.

After a brief discussion the following resolution was offered, its adoption duly moved, seconded and unanimously carried, to-wit:

Exhibit MM-1—(Continued)

Whereas, this corporation has heretofore duly initiated proceedings for the reduction of its stated capital from \$1,049,900.00 to \$524,950.00, which will thereby create a reduction surplus of \$524,950.00:

Now, therefore, be it resolved that upon the completion of said proceedings and the creation of a reduction surplus of \$524,950.00, this corporation may purchase out of such reduction surplus, not exceeding four hundred ninety-nine (499) shares of its outstanding stock, at prices not exceeding one thousand dollars (\$1,000.00) per share, from stockholders of this corporation; and

Resolved further that this Board of Directors hereby determine that by such distribution or withdrawal of reduction surplus in connection with the purchase of shares heretofore authorized, this corporation will not be rendered unable to satisfy its debts and liabilities as they fall due and that the assets of this corporation after such distribution or withdrawal, taken at their fair value, will at least equal one and one-quarter times its debts and liabilities; and

Resolved further that the officers of this corporation be and they hereby are authorized and directed to procure the authorization of such purchase of shares by the vote or written consent of the holders of at least two-thirds of the outstanding shares of this corporation, other than said 499 shares to be purchased; and

Exhibit MM-1—(Continued)

Resolved further that upon the purchase of said 499 shares, the reduction surplus of this corporation shall be reduced by the amount of the purchase price of such shares, and such shares shall be restored to the status of authorized but unissued shares.

The Chairman then read a letter from Del Amo Estate Company addressed to Dominguez Estate Company in which they offer to sell all or any part of their 980 shares of stock in the company for a price of \$800.00 per share.

After a brief discussion it was duly moved, seconded and unanimously carried, that the Chairman be authorized to carry on further negotiations with Del Amo Estate Company with reference to the purchase of this stock.

Minutes July 29, 1936

A letter from the Del Amo Estate Company dated July 17, 1936, was then read, the contents of which were as follows, to-wit:

“Dominguez Estate Company
621 South Spring Street
Los Angeles, California

Gentlemen:

Referring to our letter to you dated May 23, 1936, offering to sell all or any part of the nine hundred eighty shares of the capital stock of the Dominguez

Exhibit MM-1—(Continued)

Estate Company at and for the price of \$800.00 per share, kindly be advised that we hereby withdraw the above offer effective this date.

Very truly yours,

DEL AMO ESTATE COMPANY.

RESPONDENT'S EXHIBIT MM-2

Dominguez Estate Company

Minutes of Meeting of Board of Directors

May 25, 1936

Immediately after the adjournment of the adjourned annual stockholders meeting the Board of Directors elected thereat held its regular organization meeting at the hour of 3:00 o'clock p. m.

There were present the following directors:

H. H. Cotton, E. A. Carson, David V. Carson,
R. L. Watson, H. H. Jarrett, Wm. S. Martin,
Eugenio Cabrero.

Mr. Cotton was appointed temporary chairman and presided throughout the meeting.

The Chairman announced that the first order of business was the election of officers for the ensuing year.

The nominations of the following named officers were made and duly seconded and, upon being put

Exhibit MM-2—(Continued)

to vote, the following were unanimously elected to serve for the ensuing year:

H. H. Cotton, President; R. L. Watson, Vice-President; Wm. S. Martin, Secretary-Treasurer; Fred Drew, Assistant Secretary-Treasurer; H. H. Jarrett, Manager, Real Estate Department.

The Chairman stated that, owing to the election of new officers for the ensuing year, it would be necessary to change the signature cards for the checking accounts in the banks.

Upon motion duly made, seconded and unanimously carried, the following resolutions were adopted, to-wit:

Union Bank

Resolved that H. H. Cotton, President, or R. L. Watson, Vice-President, and Wm. S. Martin, Secretary, or Fred Drew, Assistant Secretary, be and they are hereby authorized to sign checks and drafts for and on behalf of this corporation, and to endorse and cash or deposit checks, certificates of deposit and drafts payable to this corporation.

This corporation shall be liable to and shall reimburse immediately any bank on which any check or draft signed as aforesaid may be drawn for the amount of any overdraft.

Exhibit MM-2—(Continued)

Torrance National Bank

Resolved that H. H. Cotton, President, or R. L. Watson, Vice-President, and Wm. S. Martin, Secretary-Treasurer, or Fred Drew, Assistant Secretary, of this corporation are hereby authorized to sign all checks and drafts of this corporation drawn on Torrance National Bank, Torrance, California, and that each of them is hereby authorized to endorse for deposit checks and drafts payable to this corporation.

Seaboard National Bank

Resolved that two of the following: H. H. Cotton, President, or R. L. Watson, Vice-President, and Wm. S. Martin, Secretary-Treasurer, or Fred Drew, Assistant Secretary, of this corporation be and they are hereby authorized to sign checks and drafts for and on behalf of this corporation and that each of them be and he is hereby authorized to endorse checks and drafts payable to this corporation.

Upon motion duly made, seconded and unanimously carried, the following resolution was adopted, to-wit:

Resolved that H. H. Cotton, President, and/or R. L. Watson, Vice-President, and/or Wm. S. Martin, Secretary-Treasurer, and/or Fred Drew, Assistant Secretary-Treasurer, of this corporation be and they are authorized, any

Exhibit MM-2—(Continued)

two acting jointly, to enter into a rental agreement with Security-First National Bank of Los Angeles for a safe deposit box in accordance with said bank's conditions, regulations and rules and to have access to said safe deposit box, and to do and perform, with reference to both withdrawing or changing, from time to time, the contents of said safe deposit box, or in relation to any other thing pertaining thereto, including the surrender of said safe deposit box and the keys thereof, all things which said bank or its agents may deem necessary in and about the premises; this resolution and the powers conferred hereby to remain in full force and effect until said bank is given written notice to the contrary at the office or branch at which said safe deposit box is rented.

The President then stated that he deemed it to be to the best interests of the corporation to institute proceedings to reduce its stated capital from \$1,049,900.00 to \$524,950.00. He further suggested that the outstanding par value shares of this corporation be adjusted to the stated capital by changing the par value of said shares from \$100.00 each to \$50.00 each. By this procedure there would be created a reduction surplus out of which the company could purchase its own stock to the amount of such reduction surplus from any stockholders desiring to sell their stock, providing the holders of at least two-thirds of the remaining stock consent to such purchase.

Exhibit MM-2—(Continued)

After a brief discussion the following resolution was offered, its adoption moved, seconded and unanimously carried, to-wit:

Whereas, this corporation now has issued and outstanding 10,499 shares, all of one class, of the par value of \$100.00 each; and

Whereas, the stated capital of this corporation is \$1,049,900.00; and

Whereas, it is deemed to be to the best interests of this corporation that its stated capital be reduced from \$1,049,900.00 to \$524,950.00, and that the outstanding par value shares of this corporation be adjusted to the stated capital as so reduced by changing the par value of said shares from \$100.00 each to \$50.00 each pursuant to an amendment of the articles of incorporation of this corporation; and

Whereas, this corporation has no outstanding shares entitled to preference upon liquidation, and the stated capital of this corporation as so reduced will be equal to the aggregate par value of all par value shares of this corporation to remain outstanding after such reduction:

Now, therefore, be it resolved that the stated capital of this corporation be reduced from \$1,049,900.00 to \$524,950.00, the amount of such reduction being \$524,950.00; and

Resolved further that this reduction of stated capital of this corporation shall become effective upon the filing in the office of the California Secre-

Exhibit MM-2—(Continued)

tary of State of the certificate of amendment of the articles of incorporation of this corporation changing the par value of its shares from \$100.00 each to \$50.00 each; and

Resolved further that the officers of this corporation be and they hereby are authorized and directed to procure the approval of these resolutions by the vote or written consent of the holders of a majority of the outstanding shares of this corporation, regardless of limitations or restrictions on the voting rights thereof, and to take such further action as may be necessary and proper to effect the reduction of stated capital of this corporation from \$1,049,900.00 to \$524,950.00 in accordance with the laws of the State of California.

The President stated that in order to adjust the outstanding shares to the stated capital as reduced, it would be necessary to reduce the par value of the shares of stock by an amendment of the articles of incorporation.

After a brief discussion the following resolution was offered, its adoption moved, seconded and unanimously carried, to-wit:

Whereas, it is deemed by the Board of Directors of this corporation to be to its best interests and to the best interests of its shareholders that its articles of incorporation be amended to reduce the par value of its shares from \$100.00 per share to \$50.00 per share:

Now, therefore, be it resolved that Article Sixth

Exhibit MM-2—(Continued)

of the articles of incorporation of this corporation be amended to read as follows:

“Sixth: This corporation is authorized to issue only one class of shares of stock; the total number of said shares shall be ten thousand four hundred ninety-nine (10,499); the aggregate par value of all of said shares shall be five hundred twenty-four thousand nine hundred fifty dollars (\$524,950.00), and the par value of each of said shares shall be fifty dollars (\$50.00).”

and

Resolved further that the Board of Directors of this corporation hereby adopts and approves said amendment of its articles of incorporation; and

Resolved further that the President or a Vice-President and the Secretary or an Assistant Secretary of this corporation be and they hereby are authorized and directed to procure the adoption and approval of the foregoing amendment by the vote or written consent of shareholders of this corporation holding at least a majority of the voting power, and thereafter to sign and verify by their oaths and to file a certificate in the form and manner required by Section 362b of the California Civil Code, and in general to do any and all things necessary to effect said amendment in accordance with said Section 362b.

The President stated that some of the stockholders had indicated a desire to sell a portion of their

Exhibit MM-2—(Continued)

stock in the Dominguez Estate Company. He stated that as the company was initiating proceedings to place the company in a position to purchase stock from the stockholders, a motion was in order authorizing the purchase of stock out of reduction surplus.

After a brief discussion the following resolution was offered, its adoption duly moved, seconded and unanimously carried, to-wit:

Whereas, this corporation has heretofore duly initiated proceedings for the reduction of its stated capital from \$1,049,900.00 to \$524,950.00, which will thereby create a reduction surplus of \$524,950.00:

Now, therefore, be it resolved that upon the completion of said proceedings and the creation of a reduction surplus of \$524,950.00, this corporation may purchase out of such reduction surplus, not exceeding four hundred ninety-nine (499) shares of its outstanding stock, at prices not exceeding one thousand dollars (\$1,000.00) per share, from stockholders of this corporation; and

Resolved further that this Board of Directors hereby determine that by such distribution or withdrawal of reduction surplus in connection with the purchase of shares heretofore authorized, this corporation will not be rendered unable to satisfy its debts and liabilities as they fall due and that the assets of this corporation after such distribution or withdrawal, taken at their fair value, will at least equal one and one-quarter times its debts and liabilities; and

Exhibit MM-2—(Continued)

Resolved further that the officers of this corporation be and they hereby are authorized and directed to procure the authorization of such purchase of shares by the vote or written consent of the holders of at least two-thirds of the outstanding shares of this corporation, other than said 499 shares to be purchased; and

Resolved further that upon the purchase of said 499 shares, the reduction surplus of this corporation shall be reduced by the amount of the purchase price of such shares, and such shares shall be restored to the status of authorized but unissued shares.

The President then read a preamble and resolution passed and adopted by the stockholders at their adjourned annual meeting.

Thereupon the following resolution was offered, its adoption duly seconded, and the same was adopted by the unanimous vote of all directors present:

Whereas, at the annual meeting of the stockholders of Dominguez Estate Company held on May 25, 1936, the following preamble and resolution was duly adopted:

Whereas by a certain indenture or contract of agreement and settlement dated the 8th day of May, 1936, filed in the Superior Court of the State of California in and for the County of Los Angeles, upon the 13th day of May, 1936, in the Matter of the Estate of Maria de Los Reyes D. de Francis,

Exhibit MM-2—(Continued)

deceased, designated as Probate No. 136707 in the records of said Court, to which reference is hereby made, it was provided that certain corporations should execute general releases to H. W. O'Melveny, Stuart O'Melveny, Donald O'Melveny and John O'Melveny; and

Whereas the said agreement of settlement or compromise, above referred to, provides that it shall be approved by the judge of said Superior Court of Los Angeles County having jurisdiction thereof, and furthermore provides for certain obligations to be performed by the said O'Melvenys, mentioned as parties of the first part in said agreement, which obligations are fully set forth in paragraphs 1 and 2 of said agreement, and that in such event Dominguez Estate Company shall release said O'Melvenys from any and all claims, actions or causes of action it may or might have against said O'Melvenys;

Now, therefore, be it resolved that the directors of the Dominguez Estate Company be and they hereby are requested, authorized and directed to execute in the name of this corporation and under its seal, the following agreement of release, which is in words and figures as follows, to-wit:

“Dominguez Estate Company, for valuable consideration to it moving, receipt whereof is hereby acknowledged, does hereby release and forever discharge H. W. O'Melveny, Stuart O'Melveny, Donald O'Melveny and John O'Melveny, and each of them, from and against all demands, claims, actions,

Exhibit MM-2—(Continued)

causes of action and/or suits at law or in equity that it, the said Dominguez Estate Company, may now have or assert, arising out of any acts or omissions which have heretofore been done or suffered by the O'Melvenys, or any of them, of any and every nature whatsoever, including (without limiting the generality of the foregoing) any and all acts or omissions in connection therewith, directly or indirectly, as officers, directors, attorneys, agents or employers of the Dominguez Estate Company, or in any capacity or capacities whatever, whether like or unlike the foregoing, from the beginning of the world to date.

In witness whereof, this instrument has been duly executed by the President and Secretary of the corporation, and the corporate seal attached hereto, pursuant to authority to them granted by a resolution passed and adopted at a special meeting of the board of directors of this corporation duly and regularly called and held upon the 25th day of May, 1936, at 3:00 o'clock p. m., at which meeting a full board of directors were present, authorizing the execution of this instrument.

DOMINGUEZ ESTATE
COMPANY,

By
President,

By"
Secretary.

Exhibit MM-2—(Continued)

Resolved further that on the execution of the said release by the proper officers the same be deposited in escrow with the Title Insurance and Trust Company, as escrow holder, to be by it held and not delivered until the performance of the following conditions, to-wit:

Upon condition that said agreement has been approved and confirmed by the judge of the Superior Court of Los Angeles County; and

Upon condition, furthermore, that the O'Melvyns have fully performed those certain obligations to be performed by them, which obligations are fully set forth in paragraphs 1 and 2 of said agreement.

Be it further resolved that the directors of this corporation be and they hereby are authorized, empowered and instructed to pass a resolution authorizing its officers, to-wit, its President and Secretary, to execute, seal, acknowledge and deliver said release, subject to the conditions herein last above set forth, and this shall be their warrant therefore."

Now, therefore, be it resolved that in accordance with the foregoing resolution, the Dominguez Estate Company hereby releases the persons named in said stockholders resolutions from the claims and causes of action, therein set forth and in evidence thereof the President and Secretary of this corporation are authorized and directed to execute a release in the language and form set forth in said stockholders'

Exhibit MM-2—(Continued)

resolution, in the name of this corporation and under its corporate seal, and to deliver the same in escrow, subject to the conditions named in said resolution of the stockholders, as and for the act and deed of this corporation.

Resolved further that the President of this corporation be given power to sign said escrow agreement and to do all other things necessary to carry into effect the foregoing resolutions.

The Chairman then reported on a tax conference had with the Internal Revenue Department regarding a penalty on the 1933 income tax return. He stated the penalty was assessed for violation of Section 104 of the Revenue Act of 1932. At the conclusion of the meeting the Agent in Charge of the hearing stated that he would review the case and if the assessment was not dropped we would be notified.

The Chairman then read a letter from Del Amo Estate Company addressed to Dominguez Estate Company in which they offer to sell all or any part of their 980 shares of stock in the company for a price of \$800.00 per share.

After a brief discussion it was duly moved, seconded and unanimously carried, that the Chairman be authorized to carry on further negotiations with Del Amo Estate Company with reference to the purchase of this stock.

The Chairman then stated that the offices now

Exhibit MM-2—(Continued)

occupied by the company were inadequate for the transaction of the business, and that offices could be obtained in the building at 621 South Spring Street, whereby the offices of Dominguez Estate Company, Carson Estate Company and the Watson Land Company could be consolidated and effect a saving in rental.

It was duly moved, seconded and unanimously carried, that the principal office of the company in Los Angeles County be removed to 621 South Spring Street, Los Angeles, California, effective as of June 20, 1936.

There being no further business to come before the meeting, the meeting adjourned at 3:30 o'clock p. m.

H. H. COTTON,
Chairman.

Attest: FRED DREW,
Secretary.

United States Circuit Court of Appeals
for the Ninth Circuit

Tax Court Docket No. 2257

VICTORIA L. COTTON,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S STATEMENT OF POINTS TO
BE RELIED UPON AND DESIGNATION
OF PARTS OF THE RECORD TO BE
PRINTED.

Comes now Victoria L. Cotton, the petitioner for review in the above entitled cause, by and through her counsel, and states that the points upon which she intends to rely in this case are as follows:

The Tax Court of the United States erred:

(A) In determining and deciding without any evidence or substantial evidence in support thereof a value of \$900.00 per share for the stock of Dominguez Estate Company.

(B) In determining and deciding without any evidence or substantial evidence in support thereof a value of \$990.00 per share for the stock of Francis Land Company.

(C) In determining and deciding without any evidence or substantial evidence in support thereof

a value of \$500.00 per share for the stock of Carson Estate Company.

(D) In denying petitioner's Motion for Re-hearing.

(E) In denying petitioner's Motion for Re-consideration.

(F) In denying petitioner's Motion for Review of Report by the Full Court.

(G) In finding and deciding that Dominguez Estate Company was a holding company.

(H) In finding and deciding that Dominguez Estate Company was not an operating company.

(I) In failing to find and decide that Dominguez Estate Company was an operating company.

(J) In finding and deciding without any evidence or substantial evidence in support thereof that the fair market value of the oil properties of Dominguez Estate Company was \$4,500,000.00.

(K) In failing to take into consideration the fact that the oil properties of Dominguez Estate Company sought to be valued were of a speculative nature necessitating the consideration of speculative matters, and in failing to take into consideration all elements and factors, speculative and otherwise, that affect such value.

(L) When determining the fair market value of the oil properties of Dominguez Estate Company, in failing to take into consideration:

(1) Comparative sales of oil royalties.

(2) Established and approved methods of determining such values.

(3) The known and future income tax burdens on the estimated probable future income from said oil properties.

(4) Every element, physical or otherwise, which will reflect on the income emanating from the operation or production of the oil properties.

(5) The opinion of qualified and experienced witnesses.

(6) The stipulated facts and documents and evidence contained in the record.

(M) In determining the fair market value of the oil properties of Dominguez Estate Company to erroneously assume, contrary to the facts set forth in the stipulation and record, that the "computation of the estimated probable future income from the oil properties" was a fixed, certain amount to be received.

(N) When determining the fair market value of the oil properties of Dominguez Estate Company, in giving credence to the opinions expressed by witnesses Grimes and Phillips, who are not oil engineers and who were not familiar with the oil properties and whose value was based in the one case, upon an erroneous formula derived merely from stock market quotations of a date more than five months prior to the date of the gift, and in the

other, upon a misapplication of a formula prepared by someone else and without having been informed as to the estimated probable future production in barrels.

(O) When determining the fair market value of the oil properties of Dominguez Estate Company, in accepting the values given by witness Grimes and Phillips, whose testimony was substantially repudiated by four other witnesses called by the respondent.

(P) When determining the fair market value of the oil properties of Dominguez Estate Company, in assuming that witness Eitner gave an opinion as to the fair market value of said oil properties.

(Q) When determining the fair market value of the stock of the Dominguez Estate Company, in failing to take into consideration:

- (1) The company's net worth.
- (2) The company's earning power.
- (3) The company's dividend-paying capacity.
- (4) The effect upon the value of said stock of income tax burdens.
- (5) The relative values, in relation to assets and earnings of listed stocks as required by section 811(k) of the Internal Revenue Code.
- (6) The then depressed economic conditions.
- (7) All other relevant factors having a bearing

upon the said stock as required by respondent's regulations and established court decisions.

(R) In assuming that the fair market value of the stock of Dominguez Estate Company was a sum equivalent to the value of its net assets divided by the number of its outstanding shares, and in giving credance to the testimony of experts who admitted that their values were obtained by dividing the assets by the number of shares outstanding.

(S) In failing to give proper discount for the fact that petitioner's 200 shares of the stock of Carson Estate Company, the subject of the gift, were a minority interest unable to force a liquidation.

(T) In considering transfers of the stocks in question between members of the families where the stipulated facts showed that such transfers were too far removed from June 5, 1941, to have any relevancy or materiality in a determination of value as of that date, and were not bona fide, arms-length transactions having any relevancy to the question of fair market value.

Petitioner hereby designates the entire record, as certified to the Clerk of the above entitled Court, as necessary to be printed for the consideration of the points set forth above. Petitioner also designates this Statement of Points and Designation as necessary to be printed.

Dated December 20th, 1946.

/s/ A. CALDER MACKAY,

/s/ ARTHUR McGREGOR,

/s/ HOWARD W. REYNOLDS,

/s/ ADAM Y. BENNION,

Counsel for Petitioner.

Personal service of a copy of the foregoing Statement of Points and Designation is hereby acknowledged this 24th day of December, 1946.

/s/ J. P. WENCHEL,

SLY

Chief Counsel, Bureau of
Internal Revenue,

Counsel for Respondent.

[Endorsed]: Filed Jan. 2, 1947.

No. 11508

United States
Circuit Court of Appeals
For the Ninth Circuit.

CHESTER FIPPIN and ST. CLAIRE CORPORATION, a corporation,

Appellants,

vs.

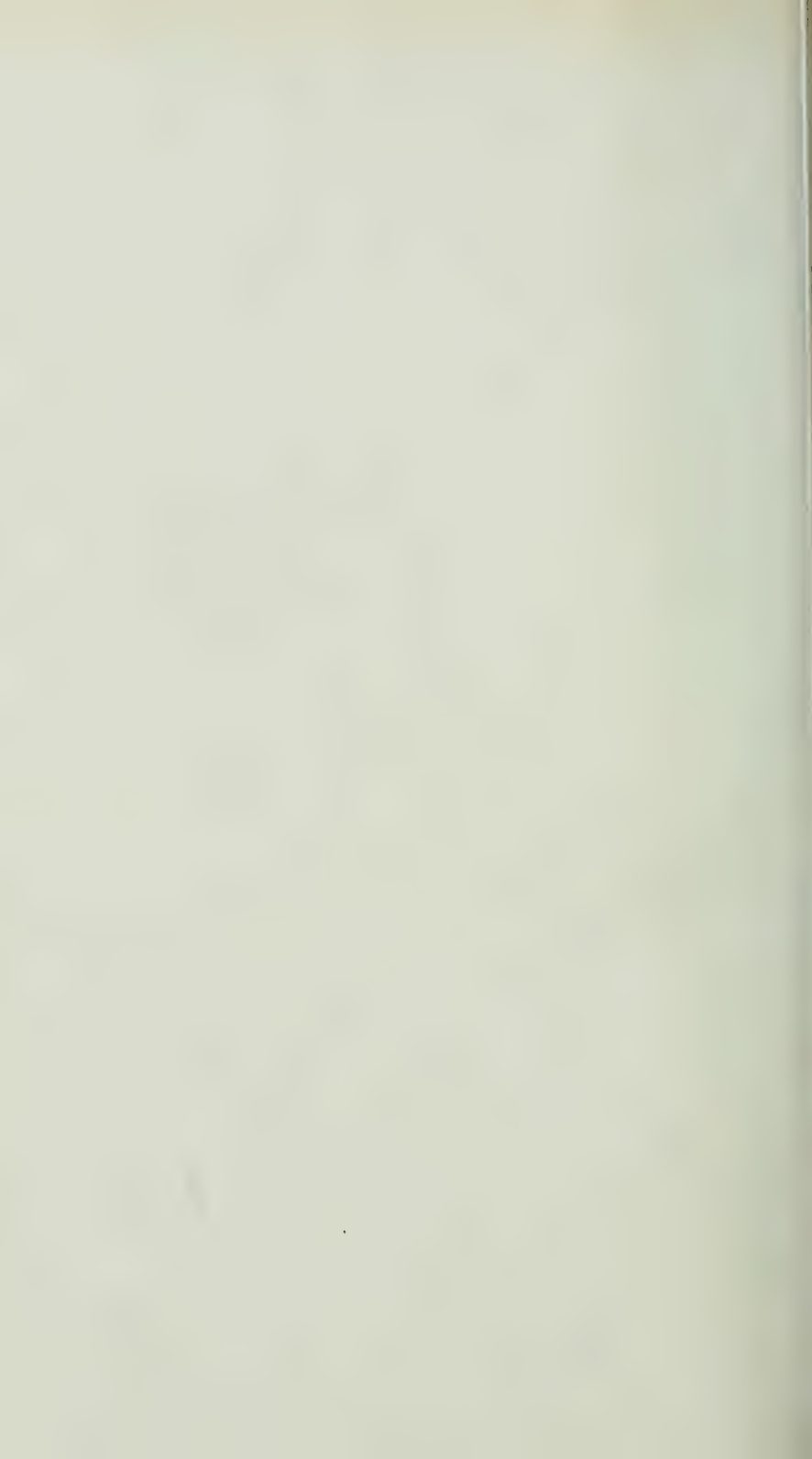
UNITED STATES OF AMERICA,

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United States
for the District of Nevada

FILED



No. 11508

United States
Circuit Court of Appeals
For the Ninth Circuit.

CHESTER FIPPIN and ST. CLAIRE CORPORATION, a corporation,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United States
for the District of Nevada

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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For the Appellant.

MILES N. PIKE,
United States Attorney,
Reno, Nevada,
For the Appellee. [1*]

* Page numbering appearing at foot of page of original certified Transcript of Record.

In the District Court of the United States
of America

in and for the District of Nevada

No. 11,481

UNITED STATES OF AMERICA.

Plaintiff,

vs.

CHESTER FIPPIN, JAMES F. BOCCARDO,
and ST. CLAIRE CORPORATION (a California corporation),

Defendants.

INFORMATION FOR VIOLATION

App. Sec. 633, T.50, USC;

VHP-1; 11 F.R. 3190

The United States Attorney Charges:

Count One

That at all times mentioned herein the defendant, St. Claire Corporation, was, and still is, a corporation duly organized and existing by virtue of the laws of the State of California, and engaged primarily in the ownership and operation of certain real properties located in the States of California and Nevada.

That the President of the United States, acting under the authority vested in him as President by the Constitution and Statutes of the United States, including Title I of the First War Powers Act of

1941, and by Title III of the Act of Congress of March 28, 1942 (Public Law No. 507, 77th Congress), known as the "Second War Powers Act, 1942," as amended by the Act of Congress of December 20, 1944 (Public Law No. 509, 78th Congress, and by the Act of Congress of December 28, 1945 (Public Law No. 270, 79th Congress), did, by Executive Order 9638 of October 6, 1945, establish the Civilian Production Administration, and vested in said Administration all the functions, powers and duties of the War Production Board.

That pursuant to the functions and powers delegated to the Civilian Production Administration, certain orders, regulations and [2] directions were duly and lawfully issued for the purpose of controlling and conserving materials and facilities for use in the low cost housing program to meet the needs of returned veterans. Among the orders so issued was Veterans' Housing Program Order 1 (VHP-1), issued March 26, 1946, and amended from time to time thereafter.

By this Order VHP-1, it is found that the fulfillment of requirements for defense of the United States has created a shortage in the supply of materials and facilities required for defense, for export and private account, and it would be impossible to construct the unprecedented number of low cost housing accommodations to meet the needs of returning veterans without diverting critical materials from deferrable or less essential construction. Order VHP-1, as issued March 26, 1946, and subsequently amended, forbids the beginning of cer-

tain types of construction, as defined in the order, after the effective date of the Order, March 26, 1946, unless exempted under the said Order or specifically authorized by the Civilian Production Administration.

That defendants, Chester Fippin, James Boccardo and St. Claire Corporation (a California Corporation), and each of them, on or about May 1, 1946, without authorization of the Civilian Production Administration, wilfully did begin the construction of commercial buildings to contain a cocktail lounge, bar, gambling casino, storage room, office, rest rooms and living quarters for employees, located on the west side of U. S. Highway 50, approximately one mile east of the California-Nevada State Line, in Douglas County, State and District of Nevada, and subsequently known as "Tahoe Sky Harbor Casino," and that the cost of said commercial buildings was approximately Forty Thousand Four Hundred Five Dollars and Eighteen Cents (\$40,405.18), the same being new construction of the type prohibited by the aforesaid Order VHP-1, and was approximately Thirty-Nine Thousand Four Hundred Five Dollars and Eighteen Cents (\$39,405.18) in excess of the One Thousand Dollar (\$1000.00) exemption provided by Paragraph (d) (1)(iii) of said Order.

Count Two

The United States Attorney aforesaid realleges all of the allegations [3] of the first count of this In-

formation except that contained in the last paragraph thereof.

That defendants, Chester Fippin, James F. Boecard and St. Claire Corporation (a California Corporation), and each of them, on and after May 1, 1946, without authorization of the Civilian Production Administration, wilfully did carry on and participate in the construction of commercial buildings to contain a cocktail lounge, bar, gambling casino, storage room, office, rest rooms and living quarters for employees, located on the west side of U. S. Highway 50, approximately one mile east of the California-Nevada State Line, in Douglas County, State and District of Nevada, and subsequently known as "Tahoe Sky Harbor Casino," and that the cost of said commercial buildings was approximately Forty Thousand Four Hundred Five Dollars and Eighteen Cents (\$40,405.18), the same being new construction of the type prohibited by the aforesaid Order VHP-1, and was approximately Thirty-Nine Thousand Four Hundred Five Dollars and Eighteen Cents (\$39,405.18) in excess of the One Thousand Dollar (\$1000.00) exemption provided by Paragraph (d)(1)(iii) of said Order.

/s/ MILES N. PIKE,

United States Attorney.

[Endorsed]: Filed Oct. 30, 1946. [4]

[Title of District Court and Cause.]

SUMMONS

To Chester Fippin:

You are hereby summoned to appear before the District Court of the United States for the District of Nevada, at the United States Postoffice Building, in the City of Reno, County of Washoe, State and District of Nevada, on the 3rd day of December, 1946, at 10:00 o'clock a. m., of said day, to answer an information charging you with violations of the Second War Powers Act and the Veterans' Housing Program, Order 1, issued pursuant thereto.

Dated at Reno, Nevada, this 30th day of October, 1946.

[Seal]

AMOS P. DICKEY,
Clerk,

By O. F. PRATT,
Deputy.

Return on Service of Writ

United States of America,
District of Nevada—ss.

I hereby certify and return that I served the annexed Summons on the therein-named Chester Fippin by handing to and leaving a true and correct copy thereof with Chester Fippin personally

at Carson City, Nevada, in said District on the 2nd day of November, 1946.

LESLIE S. KOFOED,

U. S. Marshal.

By LELAND S. BRAUNER,

Deputy. [6]

[Endorsed]: Filed Nov. 2, 1946.

[Title of District Court and Cause.]

SUMMONS

To James F. Boccardo:

You are hereby summoned to appear before the District Court of the United States for the District of Nevada, at the United States Postoffice Building, in the City of Reno, County of Washoe, State and District of Nevada, on the 3rd day of December, 1946, at 10:00 o'clock a. m., of said day, to answer an information charging you with violations of the Second War Powers Act and the Veterans' Housing Program, Order 1, issued pursuant thereto.

Dated at Reno, Nevada, this 30th day of October, 1946.

[Seal]

AMOS P. DICKEY,

Clerk,

By O. F. PRATT,

Deputy.

Received Nov. 4, 1946, U. S. Marshal's office, San Francisco, Calif.

Return on Service of Writ

United States of America,

Northern District of California—ss.

I hereby certify and return that I served the annexed Subpena on the therein-named St. Claire Corporation, a California Corporation. On James F. Boccardo, Secretary of St. Claire Corporation, Bank of America Bldg., by handing to and leaving a true and correct copy thereof with James F. Boccardo personally at San Jose, Cal., in said District, on the 4th day of November, 1946.

GEORGE VICE,

U. S. Marshal,

By WARREN D. CAIN,

Deputy. [8]

[Endorsed]: Filed Nov. 7, 1946.

[Title of District Court and Cause.]

SUMMONS

To St. Claire Corporation (a California corporation):

You are hereby summoned to appear before the District Court of the United States for the District of Nevada, at the United States Postoffice Building, in the City of Reno, County of Washoe, State and District of Nevada, on the 3rd day of December, 1946, at 10:00 o'clock a. m., of said day, to answer an information charging you with violations of the

Second War Powers Act and the Veterans' Housing Program, Order 1, issued pursuant thereto.

Dated at Reno, Nevada, this 30th day of October, 1946.

[Seal] AMOS P. DICKEY,
 Clerk,

By O. F. PRATT,
 Deputy.

Received Nov. 4, 1946, U. S. Marshal's office, San Francisco, Calif.

Return on Service of Writ

United States of America,
Northern District of California—ss.

I hereby certify and return that I served the annexed Subpena on the therein-named James F. Boccardo, Bank of America Bldg., by handing to and leaving a true and correct copy thereof with James F. Boccardo personally at San Jose, Cal., in said District, on the 4th day of November, 1946.

GEORGE VICE,
U. S. Marshal,

By WARREN D. CAIN,
Deputy. [10]

[Endorsed]: Filed Nov. 7, 1946.

Copy of Minutes of October 30, 1946

Wednesday, October 30, 1946

Court met this day at Reno, Nevada, pursuant to adjournment:

Present: Honorable Roger T. Foley, Judge; William J. Kane, Assistant U. S. Attorney; Thomas H. Williams, Deputy Marshal; Clifford Devine, U. S. Probation Officer; M. C. Klosky, Bailiff; Mrs. Marie D. McIntyre, Official Reporter; Amos P. Dickey, Clerk; O. F. Pratt, Chief Deputy Clerk.

[Title of Cause.]

Upon motion of William J. Kane, Esq., Assistant U. S. Attorney, it is ordered that the time for arraignment of the defendants herein be, and the same hereby is, set for December 3, 1946, at 10 o'clock a. m. at Reno, Nevada.

Copy of Minutes of December 3, 1946

Tuesday, December 3, 1946

Court met this day at Reno, Nevada, pursuant to adjournment:

Present: Honorable Roger T. Foley, Judge; Bruce R. Thompson, Assistant U. S. Attorney; William J. Kane, Assistant U. S. Attorney; Edward M. Ranson, United States Marshal; L. S. Brawner, Chief Deputy Marshal; M. C. Klosky, Bailiff; Mrs. Marie D. McIntyre, Official Reporter; Amos P. Dickey, Clerk; O. F. Pratt, Chief Deputy Clerk.

[Title of Cause.]

The defendants Chester Fippin, James F. Boccardo, and St. Claire Corporation by its president, Mr. DiNapoli, are present this day in Court in response to a summons heretofore issued. William J. Kane, Esq., Assistant U. S. Attorney, appears for and on behalf of the plaintiff, and John R. Ross, Esq., appears for the defendant Chester Fippin, and Morley Griswold, Esq., appears for the defendants James F. Boccardo and the St. Claire Corporation. The Clerk hands copies of the Information to the defendants herein. On motion of Mr. Kane, it is ordered that both counts of the Information be, and they hereby are, dismissed as to the defendant James F. Boccardo. On motion of Mr. Kane, it is ordered that Count 1 of the Information be, and it hereby is, dismissed as to the defendants Chester Fippin and St. Claire Corporation. Thereupon the defendants Chester Fippin and St. Claire Corporation are duly arraigned upon the Information herein, as required by law, and each enters a plea of nolo contendere as to Count 2, which pleas are accepted by the Court and the U. S. Attorney. Statements are made by counsel for the respective parties. Thereupon the Court pronounces judgment as to the defendant Chester Fippin as follows: "It is by the Court ordered and adjudged that the defendant, having been found guilty of the offense charged in Count 2 [11] of the Information is hereby fined in the sum of One Thousand Five Hundred (\$1,500.00) Dollars. It is further ordered that the Clerk deliver a certified copy of the judgment

and commitment to the United States Marshal or other qualified officer and that the same shall serve as the commitment herein." As to the defendant St. Claire Corporation, the Court pronounces judgment as follows: "It is by the Court ordered and adjudged that the defendant, having been found guilty of the offense charged in Count 2 of the Information, is hereby fined in the sum of Six Thousand (\$6,000.00) Dollars. It is further ordered that the Clerk deliver a certified copy of the judgment and commitment herein to the United States Marshal or other qualified officer and that the same shall serve as the commitment herein." The defendant Chester Fippin is remanded to the custody of the Marshal until his fine is paid. The Court retains jurisdiction for all purposes and until fines are paid. [12]

District Court of the United States
in and for the District of Nevada

No. 11,481. Criminal Information in two counts for violation of U.S.C., Title 50, Secs. 633, VHP-1; 11 F.R. 3190.

UNITED STATES

vs.

CHESTER FIPPIN, et al.

JUDGMENT AND COMMITMENT

On this 3rd day of December, 1946, came the United States Attorney, and the defendant Chester

Fippin, appearing in proper person, and by counsel, and,

The defendant having been convicted on plea of nolo contendere of the offense charged in the information in the above-entitled cause, to wit: Ct. 1—Dismissed. Ct. 2—did, on or after May 1, 1940, without authorization of the Civilian Production Administration, wilfully carry on and participate in the construction of commercial buildings to contain a cocktail lounge, etc., located on the west side of U. S. Highway 50, approximately one mile east of the Calif.-Nev. State Line in Douglas County, Nev., and that the cost of said commercial building was approximately \$40,405.18, the same being new construction of the type prohibited by Order VHP-1, and was approximately \$39,405.18 in excess of the \$1,000 exemption provided by Para. (d)(1)(iii) of said Order, and the defendant having been now asked whether he has anything to say why judgment should not be pronounced against him, and no sufficient cause to the contrary being shown or appearing to the Court, it is by the Court

Ordered and adjudged that the defendant, having been found guilty of said offense, is hereby fined in the sum of One Thousand Five Hundred (\$1,500.00) Dollars.

It is further ordered that the Clerk deliver a certified copy of this judgment and commitment to the United States Marshal or other qualified officer

and that the same shall serve as the commitment herein.

[Seal] /s/ ROGER T. FOLEY,
United States District Judge.

A True Copy. Certified this 3rd day of December,
1946.

/s/ AMOS P. DICKEY,
Clerk,

By /s/ DAN MURPHY,
Deputy Clerk. [13]

District Court of the United States
in and for the District of Nevada

No. 11,481. Criminal Information in two counts for
violation of U.S.C., Title 50, Secs. 633, VHP-1;
11 F.R. 3190.

UNITED STATES

vs.

ST. CLAIRE CORP. (a Calif. Corp.), et. al.

JUDGMENT AND COMMITMENT

On this 3rd day of December, 1946, came the United States Attorney, and the defendant St. Claire Corp., appearing in proper person, and by counsel, and,

The defendant having been convicted on plea of nolo contendere of the offense charged in the Information in the above-entitled cause, to wit: Ct. 1—Dismissed. Ct. 2—did, on or after May 1, 1946, without authorization of the Civilian Production

Administration, wilfully carry on and participate in the construction of commercial buildings to contain a cocktail lounge, etc., located on the west side of U. S. Highway 50, approximately one mile east of the Calif.-Nev. State Line in Douglas County, Nev., and that the cost of said commercial building was approximately \$40,405.18, the same being new construction of the type prohibited by Order VHP-1, and was approximately \$39,405.18 in excess of the \$1,000 exemption provided by Para. (d)(1) (iii) of said Order, and the defendant having been now asked whether it has anything to say why judgment should not be pronounced against it, and no sufficient cause to the contrary being shown or appearing to the Court, it is by the Court

Ordered and adjudged that the defendant, having been found guilty of said offense, is hereby fined in the sum of Six Thousand (\$6,000.00) Dollars.

It is further ordered that the Clerk deliver a certified copy of this judgment and commitment to the United States Marshal or other qualified officer and that the same shall serve as the commitment herein.

[Seal] /s/ ROGER T. FOLEY,
United States District Judge.

A True Copy. Certified this 3rd day of December, 1946.

 /s/ AMOS P. DICKEY,
 Clerk,
By /s/ DAN MURPHY,
 Deputy Clerk. [14]

[Title of District Court and Cause.]

ARRAIGNMENT AND SENTENCE

Be it remembered, that the above-entitled matter came on regularly for hearing before the Court at Reno, Nevada, on Tuesday, the 3rd of December, 1946, the plaintiff being represented by Wm. J. Kane, Esq., and the defendants, Chester Fippin and James F. Boccardo, being present in court with their counsel, John Ross, Esq., and the defendant St. Claire Corporation being represented by Morley, Esq. The following proceedings were had:

Mr. Kane: Your Honor, this is the case of United States against Chester Fippin, James F. Boccardo and the St. Claire Corporation. They are in court, your Honor, by virtue of information filed for violation of Section 633, Title 50 and VHP, which is Veterans Housing Program, No. 1. They are not in custody. This is under a summons, rather than an order, issued and I have had a number of conferences with counsel for the parties concerned in this matter, your Honor, and after their arraignment I would like to make a statement which will be in the nature of dismissal of certain defendant and dismissal of perhaps one of the counts of pleas entered by other defendants. [15]

The Court: You may proceed with the arraignment, Mr. Clerk.

Clerk reads.

Q. (By the Clerk) Chester Fippin, is that your true name? A. Yes.

Q. And James F. Boccardo, is that your true name? A. Yes.

Clerk continues reading.

Mr. Griswold: We waive the reading.

The Court: I would like to have it read. I want to know something about it.

Clerk continues reading.

Mr. Kane: Your Honor please, before any pleas are entered in this connection I would like to make a statement that it is our understanding that the defendants, Chester Fippin and St. Claire Corporations, will enter pleas of nolo contendere, as I understand, to Count 2 in the information and we will move for the dismissal of the information against the defendant James F. Boccardo.

The Court: Motion will be deferred until after the pleas are made.

Mr. Griswold: That is correct, with the understanding——

The Court: Before the motion is determined the pleas will be entered. Mr. Fippin, you have heard the reading of the first count in this information. Are you ready at this time to enter your plea?

Mr. Kane: We move to dismiss the first count, your Honor.

The Court: You have heard the reading of the second count, Mr. Fippin, what is your plea?

A. Plead nolo contendere.

The Court: Are you willing? [16]

Mr. Kane: Yes, we have no objection, your Honor, that is with the consent of counsel, Mr. Ross, present?

Mr. Ross: Yes.

The Court: Mr. Boccardo——

Mr. Kane: We move dismissal of the information, Count 1 and Count 2, as to Mr. Boccardo.

The Court: The motion to dismiss the first count as to Mr. Fippin is granted and both counts are dismissed on motion of the United States Attorney, in so far as the defendant James F. Boccardo is concerned. How about this corporation?

Mr. Griswold: The corporation is represented by Mr. Boccardo as an officer of the corporation and the corporation is ready at this time to plead.

Mr. Kane: We move dismissal of Count 1 as to the corporation and they make a plea on Count 2.

The Court: You represent the corporation, the St. Claire Corporation, Mr. Boccardo?

Mr. Boccardo: Yes, your Honor.

The Court: Have you anything to show that?

Mr. Boccardo: I have in my hotel room a certified copy of the articles of incorporation.

The Court: And authority to appear here?

Mr. Boccardo: Yes, it is authority to appear here.

The Court: If the United States attorney is satisfied.

Mr. Kane: May the record show that Mr. Di Napoli is present.

The Court: I understand you are president of the St. Claire Corporation?

Mr. Di Napoli: Yes, your Honor. [17]

The Court: You have heard the reading of the information and particularly the second count?

A. Yes.

Q. Are you ready at this time to enter your plea of guilty or not guilty? A. Nolo contendere.

The Court: You are satisfied?

Mr. Kane: No objection.

The Court: So the plea of nolo contendere of St. Claire Corporation to Count 2 may be entered. Now as to the defendant Chester Fippin and the corporation, have you anything to say at this time why judgment should not be pronounced against you according to law? I would like to get that question addressed to the corporation. Have you, as president of the corporation and on its behalf, Mr. Di Napoli, anything to say why judgment of the Court should not be pronounced against you according to law?

Mr. Griswold: As attorney for the St. Claire Corporation, we have no objection at this time. The record may so show.

Mr. Ross: The same is true as to Mr. Fippin.

The Court: I would like to hear from the United States attorney.

Mr. Kane: Your Honor, without taking too much time of the Court—I know the Court is very busy—I call your attention to the fact that the Second War Powers Act is involved in this case. It is a misdemeanor. The plea which is entered is the same nature as a plea of guilty and the fine that may be imposed is up to ten thousand dollars

and up to one year in jail. This is something new and it is the first time it has been before this court, the violation of the Veterans Housing Program that affects houses for veterans. We have given this case considerable thought, your Honor, both before and since the filing of the information. We realize that it is something [18] new in our law enforcement and judicial procedure and we feel that these laws were intended for a very noble purpose. They were not criminal matters prior to March 26th when the VHP went into effect, but nevertheless they were prohibited. We do not believe, and do not recommend, that in the case of either defendants—the corporation, of course, may not be considered in this, but Mr. Fippin—that a jail sentence is indicated or recommended. We do not recommend it. But we do believe a substantial fine is the proper punishment and we would recommend, after serious thought and consideration, a fine of a thousand dollars against the defendant Fippin and a fine of five thousand dollars against the St. Claire Corporation. We do not believe that is too punitive but sufficiently severe to prevent violations of this nature in the future. Perhaps Mr. Griswold has something to say or Mr. Ross in that connection.

Mr. Ross: If the Court please, we join in the comments made by counsel that the purpose of this act was indeed worthy—

The Court: I would like to get the record straight as to which of the defendants you represent.

Mr. Ross: The defendant Fippin, your Honor, and Mr. Griswold represents the defendant corporation, St. Claire Corporation. I said, if the Court please, as counsel for the defendant Fippin, I join and concur in the comments made by counsel, the act was indeed for a purpose that we all recognize as very worthy one. I can only say that as to the defendant and others in his particular situation, who have been involved in these business deals for a year or two prior to the enactment of the section which we are now under, it imposed rather harsh conditions upon them and the violation in this instance, I feel, was not an entire disregard of any law or regulation, but was merely an attempt to salvage and save a situation that was [19] under way and unfortunately ran counter-wise to the present section and we feel that the fine suggested is nominal and if the Court imposes that we will be very glad to pay it.

Mr. Griswold: May it please the Court, on behalf of the St. Claire Corporation, I think well, I do not want having a nolo contendere plea entered and then try to show that we are not guilty. It means that we have no defense to the second count. There is, however, this, I think that should be taken into consideration. The St. Claire Corporation were the people who advanced the money, loaned the money, for the construction that was conducted by Mr. Fippin. They violated, technically violated the law when a telegram was sent, which was more or less indefinite in its wording, and they loaned money after that time that was used in this con-

struction. I am only going to say this: these matters are all in a measure discretionary, in the sense that you have no basis, particularly under a new law of this kind, upon which to proceed. In other words, as far as we can find, there has never been a trial of one of these cases. There have probably been, not having a record of it, some pleas like this that have been entered throughout California and other places throughout the country, but there is no record of it to show. I am only going to use this as a comparative basis. Mr. Fippin—and I think the fine of one thousand dollars to Mr. Fippin is agreeable to Mr. Fippin and the United States Attorney—that comparatively five thousand dollars to the corporation—and incidentally the corporation is composed of four men, only four in the corporation, each of them owns one-fourth of that corporation—where they were not the moving spirits, the corporation was not the moving spirits, wasn't actually the people in the construction—that a fine of five thousand dollars compared to the fine of one thousand dollars of one, the four men who are paying it, is at least in my [20] opinion somewhat disproportionate. I think the fine to that corporation should not in any event exceed the amount that was fined to Mr. Fippin, that would be a thousand dollars for each one of the four men, that would be four thousand dollars, that would be the maximum, and the fine could reasonably be, if your Honor, please, the same amount charged Mr. Fippin as though each were charged in the matter and each of them had pleaded *nolo contendere*, and I can't

arrive by any process of reasoning, I can arrive at a five thousand figure. I believe that that is too high. Mr. Kane and I have discussed it a number of times. We have gone around and around about it and I make this very simple statement, and I think Mr. Kane will agree with everything I have said as being a true statement of not only facts but conditions as we have them. I think the fine should be four thousand dollars, which would make the corporation the same as Mr. Fippin, each getting fined the same amount and that the four stockholders, the four members of the closed corporation, should not in any event be fined individually, as that is what it amounts to, more than the co-defendant, Mr. Fippin, who got one thousand dollar fine. Now I leave the matter to your Honor's good judgment, with that very simple plain statement of fact under our plea of nolo contendere.

The Court: I would like to make some inquiries.

Mr. Griswold: I would be glad to answer if I can.

The Court: The purpose of this law, as I understand it in reading the section, a part of the section, was to make it possible for the veterans of the last war to have the benefit of the low cost building program that the government tried to put into effect. In other words, the purpose of the law was to assist in the housing of veterans.

Mr. Griswold: That was the purpose. [21]

The Court: And the purchase of material for non-commercial enterprises.

Mr. Griswold: I think that is true, I might state this, if the Court please, and Mr. Kane will check with me on this. This plan started as an airfield, which had a right to build up to 15 thousand dollars. It was started originally by Mr. Fippin. He had at that time 23 thousand dollars plus from Mr. Kaiser, who had loaned Mr. Fippin the money. Mr. Kaiser need and wanted his money. Mr. Fippin then came to the St. Claire Corporation to see if he could borrow money from them. It took 23 thousand dollars—this was long prior to the construction—to get Mr. Kaiser out of the picture and the St. Claire Corporation loaned Mr. Fippin that amount of money and I ask Mr. Kane to check me on any statements I make, because we want the facts here. Then Mr. Fippin started in on the construction with the representation to the St. Claire Corporation that it could be done for the 15 thousand dollars. There was some reclaimed material, second-hand material, that had come from tearing down of buildings, etc. used in the construction. It is like all these other things, when you get started on them, the St. Claire Corporation was in 23 thousand and then 15 thousand dollars. After it got in, the St. Claire Corporation had nothing to do with running the casino but after the airport was in construction, as it developed into these other things that were in conjunction with the airport, there were a lot of things that were not building, in the sense that they were commercial, and as I understand there was also some constriction given on the flying of airplanes that came in. It is so blamed mixed-up, Judge, insofar as—

The Court: There is one thing I would like to find out. Which, if any, of these defendants intended to continue the operation of [22] this project when it was completed? Were all the defendants to be interested in the proceeds, directly or indirectly?

Mr. Griswold: Well, Mr. Fippin was the one who owned it and the one who was going ahead and managing and running it and he was to pay back to the St. Claire Corporation the monies that they had advanced.

The Court: Were they to have an interest?

Mr. Griswold: After it had all been paid off, then there was to be an interest, as I understand it, in the St. Claire Corporation, but that is something that was in the future.

The Court: It was going to be a permanent arrangement, where the St. Claire Corporation was to permanently participate in the proceeds?

Mr. Griswold: Not for a number of years, and then they were, I think, as rental under the premises.

The Court: But it was going to continue indefinitely, as long as the casino operated??

Mr. Griswold: Yes, percentage lease.

The Court: It wasn't really a pure loan, was it?

Mr. Griswold: Up to now I would say it was a pure loan, but that it would ripen into a percentage lease afterwards.

The Court: The concern I have in determining the proper fines to be imposed— I adopt the recommendation so far as any jail sentence for the individual defendant is concerned, but in fixing the proper fine I want to avoid a situation whereby

this might be just a little raise in that of construction to the amount of about 10 per cent. This thought that I had is that this is the first time I have had anything to do with a case of this kind. [23]

Mr. Griswold: Any of us.

The Court: And what I have seen around Nevada and other places, I wonder why there hasn't been a little more activity along this line. The fact that people go in and build bars and casinos and get material when veterans can not find enough material to build a lean-to. Now I am going to meet this situation, Mr. Griswold, so there will be an even distribution of fines so there will be no complaint on that score.

Mr. Kane: May I make one statement in connection with our recommendation. Had this arisen after March 26th, when this went into effect, I do not hesitate to tell the Court that we would have recommended considerably more. That is for the purpose of the record. A good many of these things had more or less started, that is, some money had been invested beforehand and this thing came on quickly.

The Court: Was Mr. Kaiser interested in this casino and bar project?

Mr. Griswold: No, not in any way.

The Court: And did it change from an airport venture to a casino and gambling proposition immediately after Mr. Kaiser was out of it?

Mr. Griswold: No, it was the same plan all the time before.

The Court: What is the state of the work there now?

Mr. Griswold: All finished, finished for Decoration Day, the first of June, a long time ago.

The Court: Well, regarding the defendant corporation, it will be the judgment of the Court that by virtue of the plea of *nolo contendere* to the charge contained in the second count of the information, involving a violation of Section 633, Title 50, U. S. Appendix and the regulations therein mentioned and set forth in the construction [24] of a building contrary to the rules and regulations, that as punishment therefor the corporation be fined in the sum of six thousand dollars, and the defendant Fippin will please stand. By virtue of your plea of guilty to the charge contained in the information, that is in the second count of the information, it is adjudged that the defendant is guilty of the charge therein contained, involving a violation of Section 633, Title 50, U. S. Code, of the Appendix, involving a violation of the regulations against the use of materials in other than the class of buildings permitted by law, and as punishment therefor it is ordered and adjudged that the defendant Fippin be fined in the sum of fifteen hundred dollars; the court to have jurisdiction until the fine is paid.

Mr. Griswold: The fine will be paid immediately, if the Court please.

The Court: Paid today?

Mr. Griswold: Oh yes.

The Court: And the defendant Fippin is committed to the custody of the marshal until the fine

is paid and execution issued for payment of the fine. The Court will retain jurisdiction of this case for all purposes until the judgment is completely satisfied.

Mr. Griswold: It will be taken care of.

State of Nevada,
County of Ormsby—ss.

I, Marie D. McIntyre, the duly appointed official court reporter in the United States District Court, in and for the District of Nevada, do hereby certify: That I was present and took verbatim shorthand notes of the proceedings had in the foregoing entitled matter and that the foregoing pages, numbered 1 to 14, including this page, comprise a full true and correct transcript of my said shorthand notes, to the best of my knowledge and ability.

Dated at Carson City, Nevada, December 28, 1945.

/s/ MARIE D. McINTYRE,
Official Reporter.

[Endorsed]: Filed Dec. 30, 1946. [25]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Name and address of appellant: Chester Fippin,
Carson City, Nevada;

Name and address of appellant's attorneys: James
F. Boccardo and Edwin H. Williams, 417 Bank of
America Bldg., San Jose, California;

Offense: Vilation of "Second War Powers Act, 1942", Section 663, as amended, and Veterans' Housing Program Order 1, (VHP-1) issued March 26, 1946, and particularly for commencing certain building construction without authorization of the Civilian Production Administration;

Concise statement of judgment or order, giving date and any sentence: Judgment of conviction imposing a fine of *Six Thousand* (\$6,000.00) Dollars; judgment being made and entered on or about December 3, 1946; [26]

The appellant is not confined in any institution.

The above-named appellant, Chester Fippin, does hereby appeal to the United States Circuit Court of Appeals, for the Ninth Circuit, from the above-stated judgment.

Dated: December 11th, 1946.

/s/ JAMES F. BOCCARDO,
/s/ EDWIN H. WILLIAMS,
BOCCARDO & WILLIAMS,
By EDWIN H. WILLIAMS,
Attorneys for Appellant.

[Endorsed]: Filed Dec. 13, 1946. [27]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Name and address of appellant: St. Claire Corporation, a California corporation, 417 Bank of America Building, San Jose, California;

Names and addresses of appellant's attorneys: James F. Boccardo and Edwin H. Williams, 417 Bank of America Building, San Jose, California;

Offense: Violation of "Second War Powers Act, 1942", Section 633, as amended, and Veterans' Housing Program Order 1, (VHP-1) issued March 26, 1946, and particularly for commencing certain building construction without authorization of the Civilian Production Administration;

Concise statement of judgment or order, giving date and any sentence: Judgment of conviction imposing a fine of Six Thousand (\$6,000.00) Dollars; judgment being made and entered on or about December 3, 1946; [28]

The appellant is not confined in any institution.

The above named appellant, St. Claire Corporation, a California corporation, does hereby appeal to the United States Circuit Court of Appeals, for the Ninth Circuit, from the above stated judgment.

Dated: December 11th, 1946.

/s/ JAMES F. BOCCARDO,
EDWIN H. WILLIAMS,
BOCCARDO & WILLIAMS,

By /s/ EDWIN H. WILLIAMS,
Attorneys for Appellant.

[Endorsed]: Filed Dec. 13, 1946. [29]

In the District Court of the United States
for the District of Nevada

No. 11,481

THE UNITED STATES

vs.

CHESTER FIPPIN, JAMES F. BOCCARDO,
and ST. CLAIRE CORPORATION, (a Cali-
fornia corporation)

STATEMENT OF DOCKET ENTRIES

1. Filing Information for violation of App. Sec-
tion 633, T. 50, U.S.C.; VHP-1; 11 F.R. 3190 (War
Powers Act), October 30, 1946.

2. Issuing Summons (3 originals and 3 copies
handed Marshal), October 30, 1946.

3. Entg. Order time for arraignment of def't.
herein be set for December 3, 1946 at 10 a.m. at
Reno, Nev., October 30, 1946.

4. Filing Summons, entg. return. Served Chester
Fippin, Carson City, Nevada, Nov. 2, 1946. No-
vember 2, 1946.

5. Filing Summonses. Entg. Returns. Served
James F. Boccardo at San Jose, Calif. on November
4, 1946 and served St. Claire Corporation, a Cali-
fornia Corp. by serving James F. Boccardo, Secre-
tary of St. Claire Corp, at San Jose, Calif. on
November 4, 1946, November 7, 1946.

6. Clerk hands copies of Information to defts., December 3, 1946.

7. Defendants Chester Fippin & St. Claire Corp. arraigned and enter pleas of nolo contendere to Count 2. Ordered Count 1 dismissed as to Fippin & St. Claire Corp., December 3, 1946.

8. Entg. Order dismissing case as to James F. Boccardo, December 3, 1946.

9. Judgment Order. Entg. Judgment, December 3, 1946.

10. Issuing Judgment & Commitment as to Chester Fippin & St. Claire Corp., December 3, 1946.

11. Fippin remanded til fine paid. Court retains jurisdiction until fines paid, December 3, 1946.

12. Entering Judgment as to Chester Fippin, fined in the sum of \$1500.00, December 3, 1946.

13. Entering Judgment as to St. Claire Corporation, fined in the sum of \$6000.00, December 3, 1946.

14. Filed Notice of Appeal as to Chester Fippin, December 13, 1946.

15. Filing Notice of Appeal as St. Claire Corp., December 13, 1946. (Copy of Notice in each case and Statement of Docket entries mailed C. C. of A., San Fran. 12/13/46.) (Copy of Notices mailed to U. S. Atty. 12/13/46). December 13, 1946.

Dated December 13, 1946.

/s/ AMOS P. DICKEY,
Clerk.

By /s/ J. P. FODRIN,
Deputy. [31]

In the District Court of the United States of
America in and for the District of Nevada

No. 11,481

UNITED STATES OF AMERICA,

Plaintiff,

vs.

CHESTER FIPPIN and ST. CLAIRE COR-
PORATION, a California corporation,
Defendants.

DESIGNATION OF RECORD AND PROCEED-
INGS TO BE CONTAINED IN RECORD
ON APPEAL

To Amos P. Dickey, Clerk of the above Court, and
to Miles N. Pike, United States Attorney:

Now comes Chester Fippin, by his attorneys, de-
fendant above named, and appellant, and designates
the following records and proceedings to be con-
tained in the record on appeal, to-wit:

All pleadings, records, minutes and proceedings
in this action, including the judgment and sentence
therein, and this designation, and all order, papers
and proceedings hereafter entered, filed or had in
this action in this Court.

BOCCARDO & WILLIAMS.

By /s/ EDWIN H. WILLIAMS,

Attorneys for Defendant.

[Endorsed]: Filed Dec. 20, 1946. [32]

State of California,
County of Santa Clara—ss.

Lolita W. Narvaez, being duly sworn, says:

That affiant is now and at all times herein mentioned has been a citizen of the United States, over the age of eighteen years, a resident of Santa Clara County, California, and not a party to the within action or cause; that affiant's business address is 412 Bank of America Building, San Jose, California; that affiant served a copy of the attached Designation of Record and Proceeding to be Contained in Record on Appeal by placing said copy in an envelope addressed to Mr. Miles N. Pike, United States Attorney at his office address which is Reno, Nevada which envelope was then sealed and, with postage fully prepaid thereon, was, on December 18th, 1946, deposited in the United States mail at San Jose, California; that there is delivery service by United States mail at the place so addressed or that there is regular communication by mail between the place of mailing and the place so addressed.

/s/ LOLITA W. NARVAEZ.

Subscribed and sworn to before me this 18th day of December, 1946.

[Seal] /s/ MARY ZIMMERMAN,

Notary Public in and for the County of Santa Clara,
State of California. [33]

[Title of District Court and Cause.]

DESIGNATION OF RECORD AND PROCEED-
INGS TO BE CONTAINED IN RECORD
ON APPEAL

To Amos P. Dickey, Clerk of the above Court, and
to Miles N. Pike, United States Attorney:

Now comes St. Claire Corporation, a California corporation, by its attorneys, defendant above named, and appellant, and designates the following records and proceedings to be contained in the record on appeal, to-wit:

All pleadings, minutes, records and proceedings in this action, including the judgment and sentence therein, and this designation, and all orders, papers and proceedings hereafter entered filed or had in this action in this court.

BOCCARDO & WILLIAMS,

By /s/ EDWIN H. WILLIAMS,

Attorneys for Defendant.

[Endorsed]: Filed Dec. 20, 1946. [34]

State of California,
County of Santa Clara—ss.

Lolita W. Narvaez, being duly sworn, says:

That affiant is now and at all times herein mentioned has been a citizen of the United States, over

the age of eighteen years, a resident of Santa Clara County, California, and not a party to the within action or cause; that affiant's business address is 412 Bank of America Building, San Jose, California; that affiant served a copy of the attached Designation of Record and Proceedings to be Contained in Record on Appeal by placing said copy in an envelope addressed to Mr. Miles N. Pike, United States Attorney at his office address which is Reno, Nevada which envelope was then sealed and, with postage fully prepaid thereon, was, on December 18, 1946, deposited in the United States mail at San Jose, California; that there is delivery service by United States mail at the place so addressed or that there is regular communication by mail between the place of mailing and the place so addressed.

/s/ LOLITA W. NARVAEZ.

Subscribed and sworn to before me, this 18th day of December, 1946.

[Seal] /s/ MARY ZIMMERMAN,

Notary Public in and for the County of Santa Clara,
State of California. [35]

In the District Court of the United States
for the District of Nevada

No. 11,481

UNITED STATES OF AMERICA,

Plaintiff,

vs.

CHESTER FIPPIN, JAMES F. BOCCARDO,
and ST. CLAIRE CORPORATION (a Cali-
fornia corporation),

Defendants.

CERTIFICATE OF CLERK,
U. S. DISTRICT COURT

United States of America,
District of Nevada—ss.

I, Amos P. Dickey, Clerk of the District Court of the United States for the District of Nevada, do hereby certify that I am custodian of the records, papers and files of the said United States District Court for the District of Nevada, including the records, papers and files in the case of United States of America, Plaintiff, vs. Chester Fippin, James F. Boccardo, and St. Claire Corporation (a California corporation), Defendants, No. 11,481, on the criminal docket of said Court.

I further certify that the attached transcript, consisting of 37 typewritten pages numbered 1 to 37, inclusive, contains a full, true and correct transcript of the proceedings in said case and of all papers filed therein, together with the endorsement of filing

thereon, as set forth in "Appellants' Designations of Record and Proceedings to be Contained in Record on Appeal", filed December 20, 1946, all of which are filed in this case and made a part of the transcript attached hereto, as the same appear from the originals of record and on file in my office as such Clerk [36] in Carson City, State and District aforesaid.

And I further certify that the cost of preparing and certifying to said record, amounting to \$14.80, has been paid to me by Messrs. Boccardo & Williams, Attorneys for the Appellant.

Witness my hand and the seal of said United States District Court this 8th day of January, 1947.

[Seal] /s/ AMOS P. DICKEY,
Clerk. [37]

[Endorsed]: No. 11,508. United States Circuit Court of Appeals for the Ninth Circuit. Chester Fippin and St. Claire Corporation, a corporation, Appellants, vs. United States of America, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the District of Nevada.

Filed January 11, 1947.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

In the United States Circuit Court of
Appeals for the Ninth Circuit

No. 11,508

UNITED STATES OF AMERICA,

Plaintiff,

vs.

CHESTER FIPPIN and ST. CLAIRE COR-
PORATION, a California corporation,
Defendants.

DESIGNATION OF RECORD AND PROCEED-
INGS TO BE CONTAINED IN RECORD
ON APPEAL AND STATEMENT OF
POINTS ON APPEAL

To Paul P. O'Brien, Clerk of the above entitled
Court and to Miles M. Pike, United States
attorney:

Now comes Chester Fippin, appellant, and in
accordance with Sub-division 6 of Rule 19 of the
Rules of this Court, hereby designates for printing
the following records and proceedings, the same
constituting the entire record of this case, to-wit:

- I. Information and return thereon:
2. Pleas of defendants:
3. Judgment of the Court:
4. Notice of Appeal:
5. Designation of Record and proceedings to be
contained in record on appeal:
6. Clerk's certificate to transcript of record:
7. Any and all other pleadings, minutes, orders,
records or proceedings in this action and also this
designation and statement of points on appeal.

And pursuant to the aforementioned rule appellant hereby states that upon appeal it intends to rely upon the following points:

1. That the information against this appellant fails to charge any criminal offense, and that it does not state facts sufficient to charge appellant with the commission of any crime:

2. That said information does not allege the commission of any act by appellant which is in violation of any law or statute of the United States of America:

3. That the acts charged against appellant in said information are lawful and were done within the guaranties of the United States Constitution, and in the exercise of his rights thereunder:

4. That Congress of the United States is prohibited by the provisions of the Constitution of the United States from using its war powers for the purpose of meeting a peace time emergency, and the same limitation applies of all Executive officers of the United States, and that all executive orders issued in execution of the war powers of the United States have no effect or validity in respect to peace time emergencies arising after the cessation of hostilities.

January 3, 1947.

BOCCARDO & WILLIAMS,

By /s/ EDWIN H. WILLIAMS,

Attorneys for Appellant.

[Endorsed]: Filed Jan. 6, 1947.

State of California,
County of Santa Clara—ss.

Mary Z. Lewis, being duly sworn, says:

That affiant is now and at all times herein mentioned has been a citizen of the United States, over the age of eighteen years, a resident of Santa Clara County, California, and not a party to the within action or cause; that affiant's business address is 412 Bank of America Building, San Jose, California; that affiant served a copy of the attached Designation of Record and Proceedings to be Contained in Record on Appeal and Statement of Points on Appeal by placing said copy in an envelope addressed to Mr. Miles N. Pike, United States Attorney, at his office address which is Reno, Nevada, which envelope was then sealed and, with postage fully prepaid thereon, was, on January 4th, 1947, deposited in the United States mail at San Jose, California; that there is delivery service by United States mail at the place so addressed or that there is regular communication by mail between the place of mailing and the place so addressed.

/s/ MARY Z. LEWIS.

Subscribed and sworn to before me, this 4th day of January, 1947.

[Seal] /s/ JAMES F. BOCCARDO,

Notary Public in and for the County of Santa Clara,
State of California.

[Title of Circuit Court of Appeals and Cause.]

DESIGNATION OF RECORD AND PROCEEDINGS TO BE CONTAINED IN RECORD ON APPEAL AND STATEMENT OF POINTS ON APPEAL

To Paul P. O'Brien, Clerk of the above entitled Court and to Miles M. Pike, United States attorney:

Now comes St. Claire Corporation, a California corporation, appellant, and in accordance with Subdivision 6 of Rule 19 of the Rules of this Court, hereby designates for printing the following records and proceedings, the same constituting the entire record of this case, to-wit:

1. Information and return thereon:
2. Pleas of defendants:
3. Judgment of the Court:
4. Notice of Appeal:
5. Designation of Record and proceedings to be contained in record on appeal:
6. Clerk's certificate to transcript of record:
7. Any and all other pleadings, minutes, orders, records or proceedings in this action and also this designation and statement of points on appeal.

And pursuant to the aforementioned rule this appellant hereby states that upon appeal it intends to rely upon the following points:

1. That the information against this appellant fails to charge any criminal offense, and that it does not state facts sufficient to charge appellant with the commission of any crime:

2. That said information does not allege the commission of any act by appellant which is in violation of any law or statute of the United States of America:

3. That the acts charged against appellant in said information are lawful and were done within the guaranties of the United States Constitution, and in the exercise of its rights thereunder:

4. That the Congress of the United States in prohibited by the provisions of the Constitution of the United States from using its war powers for the purpose of meeting a peace time emergency, and the same limitation applies to all executive officers of the United States, and that all executive orders issued in execution of the war powers of the United States have no effect or validity in respect to peace time emergencies arising after the cessation of hostilities.

January 3, 1947.

BOCCARDO & WILLIAMS,

By/s/ EDWIN H. WILLIAMS,

Attorneys for Appellant.

[Endorsed]: Filed Jan. 6, 1947.

State of California,
County of Santa Clara—ss.

Mary Z. Lewis, being duly sworn, says:

That affiant is now and at all times herein mentioned has been a citizen of the United States, over the age of eighteen years, a resident of Santa Clara County, California, and not a party to the within action or cause; that affiant's business address is 412 Bank of America Building, San Jose, California; that affiant served a copy of the attached Designation of Record and Proceedings to be Contained in Record on Appeal and Statement of Points on Appeal by placing said copy in an envelope addressed to Mr. Miles N. Pike, United States Attorney, at his office address which is Reno, Nevada, which envelope was then sealed and, with postage fully prepaid thereon, was, on January 4th, 1947, deposited in the United States mail at San Jose, California; that there is delivery service by United States mail at the place so addressed or that there is regular communication by mail between the place of mailing and the place so addressed.

/s/ MARY Z. LEWIS.

Subscribed and sworn to before me, this 4th day of January, 1947.

[Seal] /s/ JAMES F. BOCCARDO,

Notary Public in and for the County of Santa Clara,
State of California.

No. 11508

In the
United States
Circuit Court of Appeals
For the Ninth Circuit

CHESTER FIPPIN and ST. CLAIRE CORPORATION, a corporation,

Appellants,

VS.

UNITED STATES OF AMERICA,

Appellee.

Opening Brief of Appellants

Appeal from the District Court of the United States
for the District of Nevada

BOCCARDO & WILLIAMS

Bank of America Building,
San Jose, California.

Attorneys for Appellants.

FILED

MAR 13 1947

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No. 11508

In the
United States
Circuit Court of Appeals
For the Ninth Circuit

CHESTER FIPPIN and ST. CLAIRE CORPORATION, a corporation,

Appellants,

VS.

UNITED STATES OF AMERICA,

Appellee.

Opening Brief of Appellants

**Appeal from the District Court of the United States
for the District of Nevada**

The appellants, convicted in the District Court of the United States for the District of Nevada, for violation of the provisions of Veterans' Housing Order No. 1, issued on March 26, 1946, by the Civilian Production Administration, and sentenced to pay fines aggregating the sum of \$7,500.00, have duly appealed to this Court upon an assignment of errors and the Clerk's Record of proceedings, without a bill of exceptions, pursuant to the provisions of Rule 8 of the Criminal Appeals Rule.

JURISDICTIONAL STATEMENT.

The statutory provisions which sustain the jurisdiction are as follows:

a. THE JURISDICTION OF THE DISTRICT COURT, Title 28, Section 41, United States Code, which gives the District Courts of the United States jurisdiction "of all crimes and offenses cognizable under the authority of the United States."

b. THE JURISDICTION OF THIS COURT UPON APPEAL TO REVIEW THE JUDGMENT IN QUESTION, Title 28, Section 225, United States Code, which confers jurisdiction on appeal to review final decisions

"First in the District Courts in all cases save where a direct review of the decision may be had in the Supreme Court under Section 345 of this title."

c. THE RIGHT TO APPEAL AFTER A PLEA OF NOLO CONTENDERE is sustained by the decision in the case of

Hocking Valley Railway v. United States, 210 Fed. 735 at 737.

d. THE PLEADINGS NECESSARY TO SHOW THE EXISTENCE OF JURISDICTION:

The information. (R. 2-5.)

Pleas of nolo contendere. (R. 11.)

e. THE FACTS DISCLOSING THE BASIS OF JURISDICTION are set forth in the ensuing abstract of the case which follows immediately. In order to avoid repetition they will not be stated here.

ABSTRACT OF THE CASE.

The defendants and appellants in this case are Chester Fippin and St. Claire Corporation, a California corporation. James F. Boccardo was also named as a defendant in the information filed but both counts of the information were dismissed as to him. (R. 11.)

The charge against the defendants is stated in an unverified information consisting of two counts. (R. 2-5.)

The information alleges (in both counts) the corporate capacity of the defendant St. Claire Corporation; recites that the President of the United States, under the authority vested in him by virtue of the First and Second War Powers Act and the Constitution, established the Civilian Production Administration and vested in it all the functions, powers and duties of the War Production Board; that the Civilian Production Administration duly and lawfully issued certain orders, pursuant to the powers so vested in it, for the purpose of controlling and conserving materials and facilities for use in the low cost housing program to meet the needs of returning veterans and, in particular, issued Veterans' Housing Program Order 1 (VHP-1), and various amendments thereto. The content of VHP-1 order is recited in general terms and the information charges that this order

“forbids the beginning of certain types of construction, as defined in the order, after the effective date of the order, March 26, 1946, unless ex-

empted under said order or specifically authorized by the Civilian Production Administration."

The first count of the information charges that defendants, in violation of VHP-1, began the construction of certain commercial buildings in Douglas County, Nevada, at "Tahoe Sky Harbor Casino" which cost \$40,405.18, the same being new construction, of a type prohibited by the order and being in excess of the \$1,000.00 exemption provided by said order.

The second count charges that defendants, without authorization from the Civilian Production Administration, wilfully did carry on and participate in the construction of the same buildings, being new construction of a type prohibited by said order, and which cost \$40,405.18 and approximately \$39,405.18 in excess of the \$1,000.00 exemption.

The first count of the information was dismissed as to both appealing defendants, (R. 11), and they each entered a separate plea of nolo contendere to the second count of the information. (R. 11). Judgment of conviction was rendered against each of the appealing defendants and a fine of \$1,500.00 was imposed on defendant, Chester Fippin, (R.13) and a fine of \$6,000.00 was imposed on defendant St. Claire Corporation. (R.15).

Separate appeals were duly taken from each of the judgments of conviction. (R. 28-30).

Pursuant to the terms of Rule 8, Criminal Appeals Rules, the appeals are prosecuted upon an assignment of errors and the Clerk's Record of proceedings without a bill of exceptions. (R. 39-40).

SPECIFICATION OF ASSIGNED ERRORS RELIED ON ON APPEAL.

Assignment of Error No. 1. (R. 40).

Assignment of Error No. 2. (R. 40).

Assignment of Error No. 3. (R. 40).

Assignment of Error No. 4. (R. 40).

ARGUMENT.

1. Summary.

The only point relied upon on appeal is that the information, and particularly the second count thereof on which the appellants were convicted, fails to state facts constituting a crime and that the judgment of conviction rendered thereon is erroneous, for the following reasons:

a. Defendants were convicted on a charge that they violated an order of the Civilian Production Administration issued March 26, 1946, and designated as Veterans' Housing Program Order No. 1, (VHP-1) which purported to prohibit the construction of certain buildings in order to conserve labor and materials for veterans' housing.

This order VHP-1 was issued in excess of the powers of the Civilian Production Administration because the President in his Executive Order creating that administration particularly provided that its powers should be exercised to further "a maximum peacetime production in industry *free from war time controls*,"* and because Congress had theretofore

* All emphasis appearing in quotations is supplied by the writer.

passed the War Mobilization and Reconversion Act wherein it had specifically directed all executive agencies to

“permit the expansion, resumption or initiation of production for non-war use whenever such production does not require materials, components or facilities or labor needed for war purposes” etc.

b. VHP-1 order is issued by the Civilian Production Administration in the attempt to exercise war powers and, as charged in the information, under the authority of the First and Second War Powers Act, but the war powers of the Federal government cannot be utilized to control a peace time emergency arising after the cessation of hostilities and any attempt to do so is unconstitutional and void.

c. The information fails to charge any acts against the defendants, or either of them, in violation of VHP-1 order and an analysis of the provisions contained in that order discloses that every charge contained in the information may be true and yet the defendants be innocent of any violation of the order.

d. Congress has enacted the Veterans' Emergency Housing Act of 1946 which covers the whole field attempted to be covered by VHP-1 order and none of the acts charged against the defendants in this proceeding are covered by the criminal penalties provided for in the Veterans' Emergency Housing Act.

REVIEW OF STATUTES APPLICABLE TO THE CASE.

The basis upon which the authority to issue VHP-1 order is attempted to be laid is the Second War Powers Act, 56 Stat. 176, enacted March 27, 1942, (see 50 U. S. C. A. 631 et seq., War Appendix).

Sec. 633 of that act provides: (Sec. 2, (2))

“Whenever the President is satisfied that the fulfillment of requirements for the defense of the United States will result in a shortage in the supply of any material or of any facilities for defense or for private account or for export, the President may allocate such material or facilities in such manner, upon such conditions and to such extent as he shall deem necessary or appropriate in the public interest and to promote the national defense.”

Sec. 633, Sec. 2, (5), makes any violation of the terms of this act a misdemeanor punishable by fine and imprisonment.

The First War Powers Act, 55 Stat. 838, enacted December 18, 1941, (see 50 U. S. C. A., War Appendix, Sec. 601, et seq.), merely gives the President authority to coordinate and redistribute the functions of the various executive agencies, as he may see fit.

Both War Power Acts were enacted under the extraordinary powers which arise in time of war and their constitutionality has been sustained upon this ground.

Next came the War Mobilization and Reconversion Act, 58 Stat. 785, enacted October 3, 1944, (see 50 U. S. C. A., War Appendix, Sec. 1651 et seq.).

Sec. 1658 (b) of that act provides, in part:

"The executive agencies exercising control over manpower, production, or materials *shall permit* the expansion, resumption, or initiation of production for non-war use whenever such production does not require materials, components, facilities or labor needed for war purposes, or will not otherwise adversely affect or interfere with the production for war purposes."

Executive Order No. 9638 was issued by the President on October 4, 1945, (see 50 U. S. C. A., War Appendix, in appendix thereto p. 71). This order created the Civilian Production Administration and terminated the War Production Board, and transferred the functions of the war board to the Civilian Production Administration. It recites: (Par. 3)

"The functions and powers transferred by this order shall, to the extent authorized by law, be utilized to further a swift and orderly transition from war time production to *a maximum peacetime production in industry free from war time government controls*, with due regard for the stability of prices and costs; and to that end shall be utilized to: (a) expand the production of materials which are in short supply, (b) limit the manufacture of products for which materials or facilities are insufficient, (c) control the accumulation of inventories so as to avoid speculative hoarding and unbalanced distribution which would curtail total production, (d) grant priority assistance to break bottle-necks which would impede the reconversion process, (e) facilitate the fulfillment of relief and other essential export programs, and (f) allocate scarce materials and facilities necessary for the production of low-priced items essential to the continued success of the stabilization program of the Federal Government."

Thereafter Congress enacted the Veterans' Emer-

gency Housing Act, Public Law 388, of 79th Congress, approved May 22, 1946, (50 U. S. C. A., Sec. 1821-1833, App.). This law deals specifically with the problem of veterans' housing. (See Appendix to this brief.)

Sec. 1824 contains provisions granting authority to the Housing Expediter, an executive officer, to "allocate or establish priorities for the delivery of" materials and facilities to further public interest and effectuate the purposes of the act. He is directed to give special consideration to satisfying the requirements of the veterans of the second World War.

The provisions of Sec. 1824 of the Veterans' Emergency Housing Act, above mentioned, are the only ones contained in that law which relate to the allocation of materials, etc., or the granting of priorities in favor of veterans or to expedite or facilitate the building of homes for them.

Sec. 1827 (b) of the act makes it a crime to violate any provision of Sec. 1825, or to make a false statement in respect to the matters required to be reported under the provisions of Sec. 1823 of the act. There is no provision in the Veterans' Emergency Housing Act making it a crime to violate the provisions of Sec. 1824, which, as stated above, is the only section regulating or authorizing the control, allocation or granting of priorities in respect to the construction of veterans' housing.

We have made this review of the statutes and orders pertinent to this case in order to show that the

war powers vested in the President by the Second War Powers Act were qualified and controlled by the subsequent enactment of the War Mobilization and Reconversion Act, which contained the directive that industry should be permitted to expand whenever such expansion did not interfere with war production; that the President, in terminating the War Production Board and creating the Civilian Production Administration declared that he did so to "further a swift and orderly transition from war time production to *a maximum peace time production in industry free from war time controls*;" and that the subject matter of the veterans housing program was covered by a statute especially enacted to meet the problem and which did not make any act charged against the defendants in this case a crime.

The conclusion follows that VHP-1 was issued in the attempted exercise of a war time power which the Civilian Production Administration did not possess at the time that order was issued, that it is diametrically opposed to Congressional policy as expressed in law, and that it is void.

Applicable provisions of VHP-1 are printed on pp. 24, 25, 26 of this brief.

**THE CIVILIAN PRODUCTION ADMINISTRATION WAS
NEVER EMPOWERED TO EXERCISE A WAR POWER
OF THE FEDERAL GOVERNMENT.**

In time of peace the Federal government has no power, under the Constitution, to exercise general control over the business activities of a private citizen within the confines of one of the sovereign states of the Union. Such control must be justified, if at all on the ground that it is in exercise of a war power.

The foregoing proposition is so fundamental that neither citation of authority nor argument is needed to support it.

Accordingly the VHP-1 order here in question must find its support (1) in an Act of Congress authorizing the exercise of a war time power by the President and, (2) a proper delegation of that power by the President to the Civilian Production Administration.

The United States attorney recognized this rule and, in the information, charges that this authority is found in the Second War Powers Act, which authorizes the President, among other things, to allocate and control the distribution of materials, etc., for war purposes, and in the First War Powers Act, which authorizes the President to redistribute the functions of the various executive agencies.

However, the War Powers Acts were both temporary measures which are, by their own terms, to endure only for the war emergency and Congress retained the power to limit the operation of either of those acts by subsequent legislation enacted after the

immediate stress of the war emergency had terminated. This it did on October 3, 1944, by passing the War Mobilization and Reconversion Act, which expressed a new and different policy of Congress in regard to private peace time enterprise and, by legislative decree, delivered its mandate to all the executive agencies requiring them to "permit the expansion, resumption or initiation of production for non-war use." The words used in the act are mandatory, and do not admit of any misunderstanding. They are used by the Congress, which is the source of power, and are sufficient to nullify any and all executive authority to allocate or control private production which does not interfere with production for war purposes.

This law was followed by the directive of the President in which he abolished the War Production Board and created the Civilian Production Administration to take its place and assume its functions, further providing, in his executive order creating that Administration, that its powers should be used "to further a maximum peace time production in industry free from war time controls" etc.

This is the document whereby the Civilian Production Administration was brought to life and whereby whatever power and authority it may possess was vested in it. The President, it will be assumed, had no desire to oppose the policy of Congress as enacted in law, and it is apparent from the words used in the executive order referred to that he endeavored to carry that policy into effect when he created the Civilian Production Administration. The

Administration was changed from "War" to "Civilian" in token of the change from war to peace and the direction that it use its powers to stimulate and expand peace time industry free from war time control is incompatible with the exercise of war time control to limit and restrict peace time industry for any purpose whatever, no matter how laudable. Yet that is exactly what the administration has done in issuing VHP-1. It has issued that order in the attempted exercise of a war time power and in defiance of the will of Congress and of the President.

Schechter v. United States, 295 U. S. 495, 79 L. Ed. 1570:

"The Constitution provides that 'all legislative powers herein granted shall be vested in a Congress of the United States which shall consist of a Senate and a House of Representatives,' Art. 1, Sec. 1. And the Congress is authorized to 'make all laws which shall be necessary and proper for carrying into execution' its general power. The Congress is not permitted to abdicate or to transfer to others the essential legislative functions with which it is thus vested."

If this be true no executive agency may function in defiance of the will of Congress as expressed in law. Nor may it make rules creating new and unknown crimes unless in pursuance of plain authority, directly conferred, and consistently with and in furtherance of the will of Congress.

**POWER OF EXECUTIVES AND EXECUTIVE AGENCIES
TO ISSUE RULES, REGULATIONS AND DIRECTIVES
ARE DERIVED FROM CONGRESSIONAL AUTHORITY
AND MUST BE EXERCISED IN STRICT CONFORMITY
THERE TO.**

No administrative agency has power to enact a criminal statute, or any rule or regulation making an act a crime except to the extent authorized by Congressional action.

United States v. Eaton, 144 U. S. 677, 36 L. Ed. 591 at 594, speaking of the rule above stated, the Court says:

“Much more does this principle apply to a case where it is sought, substantially, to prescribe a criminal offense by the regulation of a department. It is a principle of criminal law that an offense which may be the subject of criminal prosecution is an act committed or omitted in violation of a public law either forbidding or commanding it.”

The Court then declares that regulations prescribed by the President or the heads of departments under authority of Congress may have the force of law;

“but it does not follow that a thing required by them is a thing so required by law as to make the neglect to do that thing a criminal offense in a citizen, when a statute does not distinctly make the neglect in question a criminal offense.”

In the case at bar not only is there no Congressional authority for the criminal prosecution of the defendants in this case but they are, in fact, prosecuted in defiance of the will of Congress as expressed in law.

It is fundamental that administrative power to

make and enforce regulations must be exercised in subordination to the acts of Congress and within the framework of the law which confers authority to make them.

Schechter v. United States, 295 U. S. 495, 79 L. Ed. 1570;

Panama Refining v. Ryan, 293 U. S. 388, 79 L. Ed. 446.

The cases above cited were decided by the "old" Court. But the same conclusion is reached in decisions by the "new" Court. See

Yakus v. United States, 321 U. S. 414, 88 L. Ed. 834.

The case last cited recognizes the rule that Congress cannot delegate its law-making power; that Congress had constitutional authority to prescribe commodity prices as a "war emergency measure;" and that the act under consideration in that case was adopted as "a temporary war time measure." Constitutionality of the act was upheld on the grounds stated and because, further, it did not constitute an attempt to delegate the law-making power of Congress but properly declared the policy and purpose of Congress so that the administrative agencies could function within the framework of the law. The Court says:

"The act is thus an exercise by Congress of its legislative powers. In it Congress has stated the legislative objective, has prescribed the method of achieving that objective—maximum price fixing—and has laid down standards to guide the

administrative determination of both the occasions for the exercise of the price fixing power, and the particular prices to be established.”

Because the law did these things the acts of the administrative agencies created to carry it into effect were held valid. But these things must affirmatively appear in order to justify the exercise of administrative power. The law must be enacted; it must declare a policy in definite terms; it must provide a method for the enforcement of the declared policy; and lay down the standards which guide the agencies which administer the law.

Unless these conditions are met then the law is not valid because Congress has merely attempted to delegate a power instead of enacting a law. These rules are too fundamental to require discussion.

Yet, in the instant case, the Civilian Production Administration does not act in accordance with the policy of Congress, nor does its action conform to the limitations which were prescribed by the executive order of the President which created it. It has assumed a power altogether greater and more arbitrary than any which it is authorized to administer and seeks to function, not within the framework of the law creating it, but entirely outside the framework of that law.

Voluminous argument could not make the situation any more clear nor would it add anything to the obvious considerations which show the VHP-1 order to be null and void.

It is significant that within two months after VHP-1 order was issued Congress passed the Veter-

ans' Emergency Housing Act of 1946, which covered the whole field of this particular subject. Why should it have passed that act if an executive agency was already empowered to issue rules and regulations which had all the force of law? And, is it not odd that Congress, in enacting that act, failed to denounce as a crime the very course of conduct which has caused these defendants to be prosecuted in this action? Appellants here complain that they are convicted of a crime which was created, out of thin air, by an administration which had no power in the premises, and for the commission of acts which Congress, in legislation covering the whole subject matter, does not make criminal.

**THE WAR TIME POWERS OF THE UNITED STATES
CANNOT BE USED TO CONTROL A PEACE TIME
EMERGENCY WHICH MAY ARISE AFTER THE CES-
SATION OF HOSTILITIES.**

The war time powers of the government are very great and are necessarily extremely arbitrary in character. Many of them are almost dictatorial in extent. It is obvious that if such powers were permitted to continue indefinitely after the cessation of hostilities, many of the constitutional guaranties would be nullified. In practical effect the unlimited continuance of war time powers would deprive this government of its character as a republic and give it many of the attributes of an absolute monarchy, in which the housing, food and freedom of action of every citizen would be subject to the control of federal executives.

Accordingly, it has been held that there must be some sort of limitation upon the continued exercise of war powers after the cessation of hostilities. That limitation was fixed by certain decisions rendered after the first world war in cases where it was sought to revive the war powers of the United States to meet a peace time emergency arising out of the great miners' strike of 1919 with its consequent shortage in the supply of coal.

Newton Coal Co. v. Davis, Director General, etc.,
126 At. 192; 281 Pa. 74.

After the first world war was declared against Germany, Congress passed the Fuel and Food Control Act, authorizing the President to appoint an administrator with power to control and fix prices of food and fuel. This administrator issued many orders in execution of these powers, and, among others, issued orders fixing the price of coal and regulating its use.

After the armistice and before the treaty of peace was signed, in January, 1919, the President suspended the operation of these orders. Some time before October 30, 1919, a nation-wide coal strike was threatened, and, on that day, the President issued a new order restoring all the former regulations which fixed the price of coal and regulated its use and directed that the orders should be executed by the Director General of Railroads.

Under this authority the Director General of Railroads seized large quantities of coal which he paid for at the prices fixed in the various price fixing orders. The suit was brought by the owner of some

of the coal seized to recover the difference between the amount paid to it by the Director General and the reasonable market value of the coal. The Director General defended on several grounds, one of which was that he was justified in making the seizure under the "implied war power" conferred upon him by the acts and orders above mentioned. The Supreme Court of Pennsylvania says: (p. 194)

"The right was based on what has been generally termed implied war power. The exercise of this right or power has as its foundation the national security and defense; it is of such paramount importance alike to the country and its citizens, and of such drastic consequence, it seems imperative it must not be carried beyond what is generally comprehended by the term, or into conditions of life not justifying its existence. When lawfully brought into action by Congress, it must be kept within its own limitations. It should not exist after the circumstances are ended through which it was brought into life, namely, war or insurrection actually existing. Until the Supreme Court of the United States determines otherwise, the act in question must be held ineffective, after the cessation of hostilities in the broadest sense, freed from technical construction by acts of Congress, having a tendency to continue, on paper only, hostile conditions into a time of peace. With no reason of national import to justify its exercise, and without constitutional authority to sustain it, courts will not uphold acts done either under an abortive power or one equally as bad—a power once good, but inert through its own limitation.

"The reason is obvious. To hold otherwise the supreme sovereign at any time may enter and dictate the most ordinary affairs of life, as may an absolute monarch. Up to the present, at least, the toleration of this in peace time is unthink-

able under our system of government. We do not assert that even when peace prevails, as contrasted with a state of war, domestic conditions may not assume such serious import as to be akin to an insurrection, though force of arms be not used; when such condition arises Congress should publicly declare it; executive officers should not be forced to use legislation intended for other purposes to justify their acts. *Apportionment of commodities or diversion of fuel stands in the same position in this respect as fixing prices.*"

* * * *

"But it is equally clear, when circumstances which gave rise to the power no longer exist, or where the executive acts outside the scope of his authority, the rights of citizens must depend on things as they are, and not on the protestations of executive officers. *Yick Wo. v. Hopkins*, 100 U. S. 356, 373, 30 L. Ed. 220; *Ex parte Virginia*, 100 U. S. 339, 25 L. Ed. 667. Even the 'war power' of Congress is subject to applicable constitutional limitations, *Hamilton v. Kentucky*, 251 U. S. 146, 64 L. Ed. 194.

"It has been held that, in war time, the courts will not accept the conclusion of military authorities, duly approved by the President, as to military necessity for exercising war powers, *Ex parte Milligan*, 4 Wall. 2, 18 L. Ed. 281. And, if this is still the law, it would seem acts done a year or so after the close of hostilities, *before* peace is actually signed, would scarcely be considered a military necessity, unless it was plainly apparent that they were a direct result of such necessity." (Emphasis added.)

The Court concludes (p. 195):

"The restoration order of October 30 was not a war measure under the act and consequently must be held to be invalid. The purpose for which the act was passed no longer existed and an order based on the 'present emergency,' the

anticipation of a coal strike, could hardly be considered as being related to the 'efficient prosecution of the war.' Nor could any statement make it so even if one had been made."

The reasoning of the decision is so evidently sound that further argument in the attempt to support it is unnecessary.

The case was taken to the United States Supreme Court and was there affirmed. See

Davis, Director General v. Newton Coal Co., 267 U. S. 292; 69 L. Ed. 617.

Another case arising under an almost exactly similar state of facts was decided by the Supreme Court of Massachusetts. See

Hood v. Davis, Director General, 151 N. E. 119, 255 Mass. 200.

Referring to the decision in *Newton Coal v. Davis*, the Court declares, (p. 122), in reference to the defendant's claim that the question of war powers and their limitations were not considered in the *Newton* cases:

"A careful study of the case as it is reported in 126 A. 192, 281 Pa. 74, and the briefs of counsel, and of the same case with briefs of counsel as reported in 276 U. S. 292, 69 L. Ed. 617, makes it impossible to assume that the Supreme Court at Washington did not consider the rules and regulations of the Fuel Administrator above quoted and relied on by the defendant."

And the Massachusetts Supreme Court followed the decisions in the *Newton* case.

It is obvious that the "First War Powers Act" and

the "Second War Powers Act" are strictly limited to the exercise of war powers. They cannot be carried over into times of peace to justify an attempt to control a purely peace time emergency which arises after the cessation of hostilities, such as the erection of buildings by private citizens.

A very similar proposition was considered by Judge Claude McCulloch in the case of *Paul A. Porter, Administrator Office of Price Administration, plaintiff v. Gertrude C. Wilson, defendant*, No. 3393, District Court of the United States, for the District of Oregon, in a decision rendered on January 25, 1947. In dismissing that prosecution, the Judge stated:

"Since December 12, 1946, when President Truman appointed General Fleming, the courts have temperately withheld judgment, waiting for Congress and the legislatures to convene so that they could deal with the clouded rent situation.

"General Fleming's appointment is said to be authorized by the First War Powers Act which provides 'for the national security and defense, for the successful prosecution of the war, for the support and maintenance of the Army and Navy, for the better utilization of resources and industries, and for the more effective exercise and more efficient administration by the President of his powers as Commander in Chief of the Army and Navy, the President is hereby authorized to make such redistribution of functions among executive agencies as he may deem necessary'

"But the act also provides 'that the authority by this title granted shall be exercised only in matters relating to the conduct of the present war.'

“The courts should not be expected longer to uphold the fiction that a war is being conducted when, in fact, there is no war.”

The rule that war powers should not be utilized to control peace time emergencies arising after the cessation of hostilities is necessary to the preservation of constitutional rights. There is no better way of suspending the operation of the Constitution than to continue the exercise of war powers indefinitely after war has ended. The formal execution of treaties of peace is generally delayed until a period of years after the war is over, and that period might be extended for five, ten or even twenty years after war has ceased to be an actuality. Is the civilian population to be subject to Federal war powers during the whole period of such delay? If so, then the Constitution may be effectively repealed by the simple expedient of delaying the treaty of peace until a Federal dictatorship is actually established, and precedents thoughtlessly created now may, at some future date, be used to further an attempt to destroy our system of Constitutional government.

**THE DEFENDANTS ARE NOT CHARGED WITH ANY
ACT IN VIOLATION OF VHP-1 ORDER.**

The information charges, (Count 2, R. 5), that defendants, “on and after May 1, 1946, without authorization of the Civilian Production Administration, wilfully did carry on and participate in the construction of commercial buildings, to contain a cocktail lounge, bar, gambling casino, storage room, office,

rest rooms and living quarters for employees and that the cost of said commerical buildings was approximately \$40,405.18 the same being new construction of the type prohibited by said order VHP-1 and was approximately \$39,405.18 in excess of the \$1,000.00 exemption provided by paragraph (d) (1) (iii) of said order."

The allegation that the cost of the building was \$39,405.18 in excess of the allowed exemption is a pure conclusion of law.

VHP-1 order provides : (d)

"This order does not restrict a construction, repair, alteration or installation job, the cost of which does not exceed the allowance given below for the particular kind of structure involved:
* * * *

"(vi) \$15,000.00 for . . . a structure used for or in connection with a railroad or street railway or a *commercial airport*," etc.
* * * *

"(4) If a structure is used for more than one purpose the use to which the greatest part of the structure will be put (computed on the basis of floor area where applicable) determines the allowance."

The building erected by defendants was for the Tahoe Sky Harbor Airport, and was used almost entirely as an airport administration building.

Many items of construction are exempt from the operation of the order and we quote a few of such exemptions.

"(2) For the purpose of determining whether a particular job is exempted from this order by paragraph (d), the 'cost' of a job means the cost of the entire construction job *as estimated at the*

time of beginning construction. This includes the cost of paid labor engaged in the construction work, regardless of who pays for it, the cost or value of new fixtures, mechanical equipment and materials incorporated in the structure whether or not obtained without paying for them, and the amount paid for contractors fees. *It does not include the cost or value of previously used fixtures, mechanical equipment and materials, the value of unpaid labor, or the cost or value of machinery and equipment (other than mechanical equipment) or the cost of labor engaged in assembling and installing the machinery and equipment."*

Supplement 2 to VHP-1 order provides:

"(c) (1) The following kinds of work do not constitute beginning construction on a proposed structure and the cost of such work need not be included in computing the cost of a job under paragraph (d) (2) of VHP-1 to determine whether the job comes within the applicable allowance under paragraph (d) (1) of the order.

"Site preparation such as excavating, grading, filling with dirt, gravel or crushed stone

"Erecting fences, work sheds and construction shanties. Laying pipes, conduits and wires outside the boundary lines of the walls of the structure. Building retaining walls not physically incorporated within the structure. . . .

"Constructing or erecting forms for concrete."

The mere charge that defendants carried on and participated in the construction of a building which cost \$40,405.18 falls far short of a showing that they violated the terms of VHP-1. A proper charge would allege the cost of construction "*as estimated at the time of beginning construction.*" It should allege facts which show within what classification the build-

ing falls so that the amount of the allowable exemption could be fixed on the basis of the alleged facts and not as a mere conclusion of law. The charge should show that the construction cost as alleged in the information was not made up of and did not include any of those items which VHP-1 order excludes from its prohibitions.

The use of "previously used" (or second hand) fixtures, mechanical equipment and materials, and the "value of unpaid labor" might easily and of themselves alone, make up ninety per cent of the cost of construction of the building. But, in addition, numerous other items, notably the preparation of the site, are excluded from the cost of work prohibited by the order.

Count 2 of the information is fatally defective in still another particular.

It is important to note that VHP-1 merely forbids the "beginning of construction" after March 26, 1946, the effective date of that order. If construction work is commenced *before* March 26, 1946, it may be continued to completion after that date without violating VHP-1. This appears clearly from the terms of the order.

Sec. (c) (2) of the order provides:

"This order forbids the beginning of certain kinds of work. To 'begin' work on a structure means to incorporate into a structure on the site materials which are to be an integral part of the structure in question. . . . The order does *not* apply to work which was begun before March 26, 1946, and which was being carried on on that

date and which is being carried on normally after that date. However this rule only applies to the particular building or other structure begun before March 26, 1946."

A charge such as that here made, that the defendants, "on and after May 1, 1946" carried on and participated in the construction of a building, does not either directly or by implication charge that such building was not in course of construction on March 26, 1946. And if, construction work on the building were begun before March 26, 1946, and carried on normally thereafter, there is no violation of VHP-1. the information in the case at bar is fatally defective in failing to allege this fact and does not charge a criminal offense against the defendants.

THE OMISSION FROM THE INFORMATION OF THE ALLEGATION OF A MATERIAL FACT CANNOT BE SUPPLIED BY INFERENCE, INTENDMENT OR IMPLICATION.

Neither the testimony nor any other portion of the record may be resorted to in order to supply a necessary allegation which is omitted from the information.

Fontana v. United States, 262 Fed. 283.

A sufficient charge of crime is necessary to sustain the jurisdiction of the District Court to render a judgment of conviction.

Albrecht v. United States, 272 U. S. 1, 71 L. Ed. 505-9.

Where the allegation of a material fact does not appear in the charge, the omission cannot be supplied by recital, inference, intendment or implication.

Danaher v. United States, 39 Fed. (2) 325.

“The general rule in reference to an indictment is that all the material facts and circumstances embraced within the definition of the offense must be stated and that, if any essential element of the crime is omitted, such omission cannot be supplied by intendment or implication. The charge must be made directly and not inferentially or by way of recital.”

United States v. Hess, 124 U. S. 486;

Pettibone v. United States, 148 U. S. 197, 37 L. Ed. 419-423.

CONCLUSION.

The Federal government is a republic and one possessing limited and restricted powers. It cannot, in times of peace, under the Constitution, control the ordinary business activities of a citizen conducted entirely within the confines of one of the sovereign states. When hostilities have ceased and peace has again blessed the land it is time that the Federal government abandon the arbitrary and dictatorial powers of war and recognize the guaranties of the bill of rights.

This is especially true as to the bureaus, departments and administrations which, greedy for power and prestige, seek to perpetuate and extend their perogatives so as to control every social and business activity of the citizen. In times of peace the citizen

should again have the rights which are guaranteed to him by the Constitution and be permitted to conduct his private business within the confines of one of the states of the Union free from the interference of bureaucrats and administrative agents. And when such executive officers seek to act in excess of the powers conferred upon them by the President of the United States, and in defiance of the policies of Congress as expressed in the laws of the United States which it enacts, there should be no difficulty in finding that their acts are nugatory and void.

We respectfully submit that the defendants in this case did not commit a crime and that the judgment of conviction rendered against them should be reversed.

Respectfully submitted,

BOCCARDO & WILLIAMS,

By JAMES F. BOCCARDO

Attorneys for Appellants.

APPENDIX

APPENDIX

**EXCERPTS FROM VETERANS EMERGENCY HOUSING
ACT OF 1946.**

“The Veterans Emergency Housing Act of 1946, May 22nd, 1946, C. 268, 60 Stat. 207, 50 U. S. C. A. App. Sections 1822 to 1833.”

Section 1824—Establishment of material priorities; order of priorities; defense priorities unaffected.

“(a) Whenever in the judgment of the Expediter there is a shortage in the supply of any materials or of any facilities suitable for the construction and | or completion of housing accomodations in rural and urban areas, and for the construction and repair of essential farm buildings, he may by regulation or order allocate, or establish priorities for the delivery of, such material or facilities in such manner, upon such conditions, and to such extent as he deems necessary and appropriate in the public interest and to effectuate the purposes of this Act (Sections 1821-1833 of this Appendix).

“(b) In issuing any regulation or order allocating or establishing priorities for the delivery of any materials or facilities under this section, the Expediter shall give special consideration to (1) satisfying the housing requirements of veterans of World War II and their immediate families, (2) the need for the construction and repair of essential farm buildings, and (3) the general need for housing accomodations for sale or rent at moderate prices. In order to assure preference or priority of opportunity

to such veterans or their families, the Expediter shall require that no housing assisted by allocations or priorities under this section shall be sold within 60 days after completion or rented within 30 days after completion for occupancy by persons other than such veterans or their families; PROVIDED, that the Expediter by appropriate regulation may allow for hardship cases.

“(c) The provisions of this section shall not be construed as in any way affecting the power of the President to assign priorities or to allocate any materials or facilities under the provisions of subsection (a) of Section 2 of the Act of June 28, 1940, entitled ‘An Act to expedite national defense, and for other purposes’ (Section 1152 of this Appendix), as amended.”

Section 1827—Injunction; penalties; jurisdiction; civil action.

“(b) Any person who wilfully violates any provision of Section 5 of this Act (said Section 1825), and any person who knowingly makes any statement false in any material respect in any description or statement required to be filed under Section 3 (Section 1823 of this Appendix), shall, upon conviction thereof, be subject to a fine of not more than \$5,000, or to imprisonment for not more than one year, or to both such fine and imprisonment. Whenever the Expediter has reason to believe that any person is liable to punishment under this subsection, he may certify the facts to the Attorney General, who may, in his discretion, cause appropriate proceedings to be brought.”

No. 11,508

In The
United States Circuit Court of Appeals
For the Ninth Circuit

CHESTER FIPPIN and ST. CLAIRE
CORPORATION, A Corporation,
Appellants,

vs.

UNITED STATES OF AMERICA,
Appellee.

APPELLEE'S ANSWERING BRIEF

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APPELLEE'S ANSWERING BRIEF

JURISDICTION

The judgment of the United States District Court for the District of Nevada was entered on December 3, 1946, against the appellants (T. R. 14-15) and fines of \$1,500.00 and \$6,000.00, respectively, were imposed and paid on said date. From this judgment an appeal was taken by both appellants for a review of the judgment under Sec. 255, U. S. C. A., Title 28.

QUESTIONS PRESENTED FOR REVIEW UPON APPEAL

The appellants have assigned four errors upon appeal and intend to rely upon the points raised in said assignments of errors (T. R. 40). In the Opening Brief of appellants, page 5, specific reference is made to the said four Assignments of Error (T. R. 40). In the Argument following, appellants state that the only point relied upon on appeal is that the Information, particularly the Second Count thereof, on which the appellants were convicted, fails to state facts constituting a crime, and that the judg-

ment of conviction rendered thereon is erroneous. The subparagraphs under said Argument, pages 5 and 6 of Appellants' Opening Brief, indicate an argument in support of the four Assignments of Error and, in addition, raise what is tantamount to an additional Assignment of Error. We shall address our reply to the Assignments of Error as set forth in Appellants' Opening Brief.

ARGUMENT

I.

The Information Against The Appellants Does Charge A Criminal Offense and Does State Facts Sufficient To Charge Appellants With The Commission of A Crime.

The Information appears on pages 2 to 5 inclusive of the Transcript of Record, consisting of two counts. We are concerned only with Count Two, to which both appellants entered pleas of nolo contendere, Count One having been dismissed upon motion of the United States Attorney (T. R. 17-19). Both Counts One and Two were dismissed as to James F. Boccardo at that time. The Information was filed October 20, 1946, under the Federal Rules of Criminal Procedure for District Courts of the United States, effective March 21, 1946. (18 U. S. C. A., 687, et seq., 1946 Cumulative Annual Pocket Part).

Rule 7(c) of said rules, sets forth the requirements of an Information as follows:

"The indictment or the information shall be a plain, concise and definite written statement of the essential facts constituting the offense charged. It shall be signed by the attorney for the government.

It need not contain a formal commencement, a formal conclusion or any other matter not necessary to such statement. Allegations made in one count may be incorporated by reference in another count. It may be alleged in a single count that the means by which the defendant committed the offense are unknown or that he committed it by one or more specified means. The indictment or information shall state for each count the official or customary citation of the statute, rule, regulation or other provision of law which the defendant is alleged therein to have violated. Error in the citation or its omission shall not be ground for dismissal of the indictment or information or for reversal of a conviction if the error or omission did not mislead the defendant to his prejudice."

Count One of the Information fully states the statute, rule and regulation, or other provision of law, which the defendants are alleged to have violated, and charged that the defendants "wilfully did begin the construction, etc." on or about May 1, 1946. The allegations of Count One were incorporated by reference in Count Two, but charged that the defendants, on and after May 1, 1946, "wilfully did carry on and participate in the construction, etc."

The question of the sufficiency of the Information is raised for the first time in this appeal. The first step in laying a foundation for an appeal, if it is apparent that the information does not state a cause of action, is to challenge the same by a proper motion in the trial court. The Transcript of Record fails to show any motion before the judgment attacking the sufficiency of the information on any ground, nor does it show any motion in arrest of the judgment under Rule 34, Federal Rules of Criminal

Procedure, 18 U. S. C. A., 1946 Cumulative Annual Pocket Part, Page 247, or for the correction or reduction of sentence under Rule 35, Federal Rules of Criminal Procedure, 18 U. S. C. A., 1946 Cumulative Annual Pocket Part, page 248.

In *Yates vs. United States*, 151 F. (2d), 580, at page 581, on October 5, 1945, the Circuit Court of Appeals, Ninth Circuit, ruled:

"The indictment was not challenged on the ground of duplicity or any other ground. Whether it was duplicitous need not be considered, the defect, if any, having been cured by verdict."

A further attack upon the sufficiency of the Information is made on the ground that there was a failure to negative the exceptions in VHP-1, pages 24-27, Opening Brief of Appellants.

In *Rose vs. United States*, 149 F.(2d), 755, at page 758, the Circuit Court of Appeals, Ninth Circuit, stated:

"We note the argument that since the tire rationing regulations contained exceptions permitting transfers in certain circumstances by retailers and since appellants were authorized dealers in tires, the language of the indictment charged no public offense. The conclusion does not follow from the stated facts. It is the unlawful scheme to prepare for and accomplish the act of commercially handling tires and tubes contrary to and not in accord with the wartime regulation that constitutes the criminal conspiracy in this case. It is in such a case that exceptions need not be negated in the indictment.

"Enough is stated in the indictment to reveal the

offense to be met and to protect against double jeopardy. The indictment is adequate."

II.

The Information Does Allege The Commission Of Acts By The Appellants Which Are In Violation Of A Statute Of The United States.

Under the War and Defense Contract Act of June 28, 1940, 50 U. S. C. A., Appendix Sec. 1152, as amended by the Second War Powers Act of 1942, enacted March 27, 1942, 50 U. S. C. A., App. 633, and the First War Powers Act of 1941, 50 U. S. C. A., App. 601, Congress granted extensive powers to the President. The Second War Powers Act (50 U. S. C. A., App. 633, Sec. 2 (2), states:

"Whenever the President is satisfied that the fulfillment of requirements for the defense of the United States will result in a shortage in the supply of any material or of any facilities for defense or for private account or for export, the President may allocate such material or facilities in such manner, upon such conditions and to such extent as he shall deem necessary or appropriate in the public interest and to promote the national defense."

Under Sec. 2(8), the said Act further states:

"The President may exercise any power, authority, or discretion conferred on him by this subsection (a), through such department, agency, or officer of the Government as he may direct and in conformity with any rules or regulations which he may prescribe."

The President of the United States, in Executive Order No. 9638, 10 Fed. Reg. 197, on October 4, 1945, transferred the functions and powers of the War Production Board,

previously established by Executive Order No. 9024, dated January 16, 1942, to the Civilian Production Administration, for the following purposes: (Paragraph 3, Executive Order No. 9638)

"The functions and powers transferred by this order shall, to the extent authorized by law, be utilized to further a swift and orderly transition from wartime production to a maximum peacetime production in industry free from wartime Government controls, with due regard for the stability of prices and costs; and to that end shall be utilized to; (a) expand the production of materials which are in short supply, (b) limit the manufacture of products for which materials or facilities are insufficient, (c) control the accumulation of inventories so as to avoid speculative hoarding and unbalanced distribution which would curtail total production, (d) grant priority assistance to break bottlenecks which would impede the reconversion process, (e) facilitate the fulfillment of relief and other essential export programs, and (f) allocate scarce materials and facilities necessary for the production of low-priced items essential to the continued success of the stabilization program of the Federal Government."

Said Order became effective November 3, 1945.

On March, 26, 1946, the Civilian Production Administration, under the authority vested in that agency under Executive Order No. 9638, above mentioned, issued the Veterans' Emergency Housing Program, Order 1 (VHP-1), effective March 26, 1946. Under Sec. 3(c) of said VHP-1, certain construction was prohibited in the following language:

"Prohibited construction. (1) No person shall begin to construct, to repair, to make additions or

alterations to, to improve, to convert from one purpose to another, or to install or to relocate, fixtures or mechanical equipment, in any structure, public or private, in the forty-eight States, the District of Columbia, Puerto Rico or the Virgin Islands, except to the extent permitted under paragraphs (d), (e) and (f), or when and to the extent specifically authorized under paragraph (h). No person shall carry on or participate in any construction, repair work, addition, improvement, conversion, alteration, installation or relocation of fixtures or mechanical equipment prohibited by this order. The prohibitions of this paragraph apply to a person who does his own construction work, to a person who gets a contractor to do the work, to contractors, sub-contractors, architects and engineers working on a job which is being carried on in violation of this order or getting others to work on it or to supply materials for it."

Under Sec. 3(j) "Violations," said Order states:

"Any person who wilfully violates any provision of this order or who, in connection with this order, wilfully conceals a material fact or furnishes false information to any department or agency of the United States is guilty of a crime, and upon conviction may be punished by fine or imprisonment. In addition, any such person may be prohibited from making or obtaining further deliveries of, or from processing or using material under priorities control, and may be deprived of priorities assistance."

Under the Second War Powers Act heretofore referred to, in which the President was empowered to delegate any agency to enforce the provisions thereof, in Sec. 2(a) 5 of Sec. 633, it was made a criminal offense for any person to wilfully perform any act prohibited under subsection (a) thereof, or any rule, regulation or order thereunder,

whether heretofore or hereafter issued, and made the violation thereof a misdemeanor subject upon conviction to a fine of not more than \$10,000.00 or imprisonment for not more than one year, or both.

In *U. S. vs. Elade Realty Corporation*, 157 F.(2d) 979, at page 980, the Circuit Court of Appeals, Second Circuit, on November 12, 1946, in affirming a conviction for violation of a regulation made pursuant to the Second War Powers Act, stated:

“The Act gave power to the President to allocate any materials of which there was a shortage ‘for the defense of the United States * * * upon such conditions and to such extent as he shall deem necessary or appropriate * * * in the public interest and to promote the national defense. Although, as we have seen, the regulations allowed prospective builders, who needed ‘priority’ materials, to set their own prices, they held them to what they set, and they imposed as a further limit upon any sale ‘the fair market price,’ and never more than \$6,000. It seems to us of no consequence whether this be called ‘price-fixing’; the only relevant question is whether the regulations were ancillary to the purpose of the Act. We hold that they were. Their primary object probably was to assure houses for those who were making munitions of war by directing such materials as were not needed for the actual manufacture of these, to the construction of cheap houses. Nobody can question that, so far as this was in fact the effect of the regulations, it implemented the Act, even under its narrowest interpretation: those who make weapons must have shelter, and the cheaper the shelter, the less drain upon the national resources. We cannot be entirely sure whether the regulations forbad all construction except

of houses for 'warworkers,' and for this reason we shall assume that 'priority' materials might be allotted to other houses. Even so, the limits imposed were such as 'to promote the national defense'; for they made it certain that any building, even though not directly connected with the production of munitions, should be cheap; and that pro tanto limited the drain upon the total stock of available materials."

In the instant case the Order VHP-1, under Executive Order No. 9638, was issued for the laudatory purpose of furnishing low-cost housing accommodations to meet the needs of returning veterans and was, we submit, an act in the public interest and to promote the national defense.

In *Rose vs. United States*, 149 F.(2d) 755, the Circuit Court of Appeals, Ninth Circuit, upheld a conviction for violation of a regulation issued by the Office of Price Administration, under the authority of the Second War Powers Act, sustaining the validity of such regulation, analagous to the present case.

III.

The Acts Charged In The Information Were Unlawful And Were Not In Violation Of The Constitutional Rights Of The Appellants

The appellants, on page 6 of their Opening Brief, contend that the First and Second War Powers Acts are unlawful delegations of war powers to control a peacetime emergency and, therefore, are unconstitutional and void. This contention, we believe, is without merit and was so determined in the case of *Rose vs. United States*, herein-

above referred to, where the Circuit Court of Appeals, Ninth Circuit, on June 4, 1945, ruled as follows:

“The Second War Powers Act, 50 U. S. C. A. Appendix, §633, is not unconstitutional. It establishes standards detailed enough to overcome the objection of an invalid delegation of power. *United States v. Randall*, 2 Cir., 1944, 140 F.2d 70; *O’Neal v. United States*, 6 Cir., 1944, 140 F.2d 908. Appellants’ contention that the Act is too vague and indefinite to form a standard of penal conduct does not give effect to subsection 2(a)(2), which authorizes the President to allocate materials or facilities in definitely prescribed circumstances.”

In *Porter vs. Shibe et al*, 158 F.(2d) 68, at page 72, the Circuit Court of Appeals, Ninth Circuit, on November 5, 1946, in passing upon the Price Control Extension Act of 1946, passed July 25, 1946, 50 U. S. C. A., Appendix, Sec. 901, ruled:

“The Act of July 25, 1946, was enacted by the Congress in the exercise of its war power. The war power is a broad and comprehensive grant. It is ‘well nigh limitless.’ It embraces those powers necessary to maintain our national defense and security. It is essential to the preservation of our country as an independent nation and the perpetuity of our liberties. While the war power is subject to the limitations of the Fifth Amendment, the courts must guard against impairing its essential attributes or endangering the ability of the nation to maintain its defense and security and its status as a free and independent state.”

The Court, at page 73, further stated:

“A law is not unconstitutional merely because it results in financial injury to a citizen where it is

reasonably necessary to preserve important public interests. Neither is it unconstitutional because it preserves one interest over another if there is a preponderant public concern in the preservation of the one over the other. Here, the important national interest is the making available to tenants of housing accommodations in important defense-rental areas at non-inflationary rentals in furtherance of the national defense and security.

“Many of the lawful demands made on the citizen in the exercise of the war power result in financial loss to the citizen. Individual suffering and sacrifice are inevitable concomitants of war. Moreover, here the financial injury is nominal only and not substantial.”

We again submit that the case now under consideration should be considered in the light of the rulings of the Ninth Circuit Court of Appeals just quoted. The purposes of the Veterans' Housing Program, as set forth in VHP-1, are tantamount in importance to the national defense and public welfare, as were the regulations under the Act of July 25, 1946.

K. & J. Markets v. Bowles, 57 F. Supp. 294, affirmed per curiam on opinion of the District Court, 148 F. (2d) 661 (C. C. A. 3); *Shreveport Engraving Co. v. United States*, 143 F.(2d) 222 (C. C. A. 5), certiorari denied, 323 U. S. 749, and *Yakus v. United States*, 321 U. S. 414, upheld the constitutionality of the War Powers Acts, the delegation of authority and the legality of orders issued thereunder.

In connection with the allocation or priority powers,

the courts have held that the administrative agency charged with its execution could properly adopt measures reasonably designed to carry out the purposes of the Act. *L. P. Stenart and Bro., Inc. v. Bowles*, 322 U. S. 398; *Shreveport Engraving Co., supra*; *Gallagher's Steak House, Inc. v. Bowles*, 142 F.(2d) 530, 534 (C. C. A. 2), certiorari denied, 322 U. S. 764; *Varney v. Warchime*, 147 F.(2d) 238, 244-245 (C. C. A. 6), certiorari denied, 325 U. S. 882.

Appellants' contention that the war powers are no longer applicable since the war is over is without merit. The Supreme Court has consistently held that a federal statute, the applicability of which is limited, by one form of words or another, to a state of war, does not cease to be operative until the state of war has been terminated by treaty, act of Congress or executive proclamation. There has been no such termination, and the war powers generally are still in effect. *Hamilton v. Kentucky Distilleries Co.*, 251 U. S. 146; *The Protector*, 12 Wall. 700, 701-702; *United States v. Anderson*, 9 Wall. 56, 70; *Commercial Trust Co. v. Miller*, 262 U. S. 51, 57. See also 40 OAG 100 of September 1, 1945.

It is well established that the power to wage war delegated to the Federal Government by Art. 1, Sec. 8 of the Constitution of the United States, encompasses the exercise of powers far beyond those directly concerned with the waging of a fighting war. Such functions as the power to fix maximum prices, (*Bowles vs. Withingham*, 321 U.

S. 503; *Taylor vs. Brown*, 137 F.(2d) 654; certiorari denied, 320 U. S. 787; *Brown vs. Wright*, 137 F.(2d) 484); to allocate scarce materials; (*Bowles vs. Wilemon*, 139 F. (2d) 730, certiorari denied, 322 U. S. 748); and to enact an alcoholic liquor prohibition statute, (*Hamilton vs. Kentucky Distilleries and Warehouse Co.*, 251 U. S. 146,) have all been upheld.

The power to wage war carries with it inherently the power to guard against the immediate renewal of the conflict and to remedy the evils which have arisen from its rise and progress. This power is not limited to the actual fighting and dispersal of the fighting forces. (*Hamilton vs. Kentucky Distilleries and Warehouse Co.* cited above).

World War II has not been terminated by the signing of treaties of peace. Since the surrender by the nations and forces at war with the United States and her allies, the President and Congress have relinquished or set aside certain wartime controls, but have not declared the period of national emergency to have ended. On December 31, 1946, the President in Proclamation 2714, 12 Fed. Reg. No. 1. in proclaiming the cessation of hostilities of World War II as of December 31, 1946, stated:

“Although a state of war still exists, it is at this time possible to declare and I find it to be in the public interest to declare that hostilities have terminated.”

The Congressional intent to continue some necessary wartime controls after the actual end of hostilities is evidenced by the Act of Congress of December 28, 1945, C.

590, Sec. 1(f) 59 Stat. 658, extending the Second War Powers Act to June 30, 1946, and on June 29, 1946, further extending the termination date from June 30, 1946, to March 31, 1947, except for the purpose of allocations of building materials, Title III of said act shall remain in force and effect until June 30, 1947. (50 U. S. C. A., Sec. 645, 1946 Cumulative Annual Pocket Part).

Congress has ratified and confirmed the action taken by the President and the Civilian Production Administration. Executive Order No. 9638, creating the Civilian Production Administration, was issued October 4, 1945. The powers previously exercised by the War Production Board under Executive Order No. 9024, of January 16, 1942, (7 Fed. Reg. 329) were thereby transferred to the Civilian Production Administration, and the War Production Board was abolished. The Civilian Production Administration, on March 26, 1946, promulgated Veterans' Emergency Housing Program Order No. 1 (VHP-1), which is the basis of the violation charged in the instant case. By the Act of Congress of March 22, 1946, (Public Law 329, 79th Congress, Chap. 107, 2d Session) the Congress of the United States appropriated "For an additional amount, fiscal year 1946, for 'Salaries and Expenses,' Civilian Production Administration, including the objects specified for the appropriation 'Salaries and Expenses, War Production Board,' in the National War Agencies Appropriation Act, 1946, \$1,500,000." By the Third Deficiency Appropriation Act, 1946, approved July 23, 1946, (Public Law 521,

79th Congress, Chap. 591, 2d Session) the Congress of the United States appropriated \$18,000,000 for the necessary expenses of the Civilian Production Administration for the fiscal year 1947.

Among the many authorities holding that subsequent Congressional enactments may be relied upon to establish confirmation and approval by Congress of the interpretation and construction placed upon legislation by executive and administrative agencies are the following Supreme Court decisions :

Brooks v. Dewar, 313 U. S. 354, S. Ct., L. Ed.

Swayne & Hoyt Ltd. v. U. S., 300 U. S. 297, S. Ct. L. Ed.

Wells v. Nickels, 104 U. S. 444, 26 L. Ed. 825.

Hirabayashi v. U. S., 320 U. S. 81, S. Ct., L. Ed.

When Congress appropriated money for the support of the Civilian Production Administration it approved the creation by the President of that executive agency for the purposes specified in the executive order and the actions of the Civilian Production Administration in the fulfillment of those purposes.

IV.

The Veterans' Emergency Housing Act Of 1946, Enacted May 26, 1946, Does Not Cover Violations Of Veterans' Housing Program Order 1, Issued March 26, 1946.

The appellants, on pages 5 and 6 of Appellants' Opening Brief, in their argument, appearing under a, b and c of the Argument Summary, appear to consolidate the As-

signments of Error Nos. 1 to 4, inclusive, and, in d. of the Argument Summary, (T. R. 6) appear to inject an argument in the nature of another Assignment of Error.

Under the Rules of the United States Circuit Court of Appeals, Ninth Circuit (Criminal Appeals Sec. 2, Assignment of Errors) the rule states:

“(d) Such assignment of errors shall form part of the transcript of the record and be printed with it. When this is not done, counsel will not be heard thereon except at the request of the court; and errors not assigned according to this rule will be disregarded, but the court, at its option, may notice a plain error not assigned.”

The exceptions not presented in the Assignment of Error are abandoned. *Roberts vs. U. S.*, 60 F.(2d) 871, at page 873.

The Veterans' Emergency Housing Act of 1946, which the appellants claim was not violated by the acts charged in the Information, was enacted May 22, 1946, after the commission of the offense set forth in the Information. The Veterans' Emergency Housing Act of 1946, therefore, is not the statute under which the appellants were prosecuted, and not under consideration herein.

The power of the Civilian Production Administration was not superseded by the Emergency Housing Act, 50 U. S. C. 821, dated May 22, 1946. This act was specifically to establish a "house-construction program" and provided for the appointment of a Housing Expediter. Both the Act and Executive Order 9686 of January 26, 1946 (11 F. R. 1032),

provided that the Expediter shall "consult and cooperate with other agencies of the Federal Government * * * with respect to the problems created by the Housing Emergency and the steps which can be taken to remedy it." Executive Order 9638 (10 F. R. 197) creating the Civilian Production Administration provided that "its functions and powers shall be utilized to further a swift and orderly transition from war-time production to a maximum peace-time production in industry free from war-time Government controls." (Underscoring supplied.) Obviously the purpose of establishing the Authority was to bring about an "industry free from war-time controls," and this statement was not intended to mean that such a purpose had already been accomplished, but was a statement of the objectives and purposes of the order. The section of the order as quoted and underscored by appellant conveys an erroneous impression. This order further provides that the Civilian Production Administration shall "allocate scarce materials and facilities necessary for the production of low priced items * * *." There is no conflict between these executive orders and the order of the Civilian Production Administration, on the one hand, and the Emergency Housing Act, on the other; in fact, the proper allocation of scarce materials by the Civilian Production Administration in cooperation with the Housing Expediter would make possible the accomplishment of the purposes of the Emergency Housing Act; they should be read together and their purposes and functions coordinated.

In Appellants' Opening Brief, page 24, line 24, appellants attempt to inject into the record a contention that "the building erected by defendants was for the Tahoe Sky Harbor Airport, and was used almost entirely as an airport administration building." There is nothing whatever in the Transcript of Record to justify or permit the consideration of such contention. The Information sets forth the charge to which the appellants entered their pleas of nolo contendere, after they and their counsel had been fully informed concerning the nature of the charges. They now seek in their appeal to present for review factual matters in conflict with the Information without, at any time prior to this appeal, raising such questions in any manner whatsoever in the trial court.

Conclusion

We submit that there is no error, either assigned or argued by the appellants or apparent in the record, to warrant a reversal of the judgment appealed from.

DATED April 7, 1947.

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In the
United States
Circuit Court of Appeals
For the Ninth Circuit

CHESTER FIPPIN and ST. CLAIRE CORPORATION, a corporation,

Appellants,

VS.

UNITED STATES OF AMERICA,

Appellee.

Appellants' Reply Brief

**Appeal from the District Court of the United States
for the District of Nevada.**

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FILED

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Appellants' Reply Brief

**Appeal from the District Court of the United States
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The answer brief of the appellee is more remarkable for what it does not say than for what it does. It does not say anything about the War Mobilization and Reconversion Act, 50 U. S. C. A. War App., Sec. 1658b, which declares:

“The executive agencies exercising control over manpower, production or materials shall permit the expansion, resumption or initiation of production for non-war use whenever such production does not require materials, components, facilities or labor needed for war purposes, or will not otherwise adversely affect or interfere with the production for war purposes.”

It must be presumed that appellee was at an utter loss to explain how an executive agency could issue a valid order in conflict with the mandate contained in this statute. Heretofore it has been conceded that the Constitution, (Art. 1, Sec. 1), vested the legislative powers of the Federal Government in the Congress.

None of the cases cited in appellee's brief even mention the statute quoted above. Only three of these cases touch on the matter of the validity of executive orders and a reading of these three discloses the reason why that statute was not mentioned in any of them.

In *Rose v. United States*, 149 Fed. (2) 755, the Court was considering an indictment for conspiracy to violate certain executive orders issued by Office of Production Management, War Production Board and Office of Price Administration, which prohibited deal-

ing in new rubber tires without a permit from the rationing board. The conspiracy was alleged to have originated on December 12, 1941, i.e., three years before the War Mobilization and Reconversion Act (quoted above) was passed by Congress.

Porter v. Shibe, 158 Fed. (2) 69, arose out of an attempt on the part of certain landlords to evict tenants during the period in the middle of 1946 when the Office of Price Administration was in a state of suspended animation. Certainly a law which relates to "manpower, production or materials" could not apply to a tenant eviction case.

United States v. Elade Realty Co., 157 Fed. (2) 979, involved a violation of a priority order issued by the National Housing Administration on February 10, 1943,—more than a year before the Congress passed the War Mobilization and Reconversion Act.

None of the foregoing cases have any significance whatever in respect to the points made in our opening brief.

Appellee cites authority in support of the proposition that Congress may ratify acts of Federal officers and agencies by making appropriations for their bene-

fit. This doctrine of implied ratification can have no application to an order issued in defiance of the express mandate of an act of Congress. There is no support either in reason or authority for any such proposition.

Appellee fails to even mention many other points contained in Appellant's Opening Brief and its answer to others does not seem to require a reply.

Respectfully submitted,

JAMES F. BOCCARDO,

Attorney for Appellants.

